

Exhibit 12

AMENDED
INTERIM REPORT NO. 6
REGARDING THE SAN DIEGO CITY
EMPLOYEES' RETIREMENT SYSTEM FUNDING
SCHEME

REPORT OF THE
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I. INTRODUCTION

San Diego's pension funding crisis began on 21 June 1996, when the board of the City's pension system agreed to allow the City to reduce contributions to the plan below amounts needed to pay for benefits already granted. On 2 July 1996, then-San Diego Mayor Susan Golding and the City Council acquiesced in this plan. In order to induce pension officials to not require the City to meet its legal duty to fully fund existing pension benefits, the Mayor and City Council granted hundreds of millions of dollars of new benefits in violation of the liability limits of the State Constitution and the City Charter. These 1996 decisions set in motion the worst financial crisis in the history of the City of San Diego.

The elaborate scheme concocted by certain City officials was also aimed at concealing the depth of the funding crisis from San Diego taxpayers and the investors who bought the City's bonds. This scheme was carried out for seven years by City officials, who will be identified in this Sixth Interim Report of the San Diego City Attorney. Currently, the pension benefit liabilities of the pension fund exceed its assets by more than \$1.7 billion dollars.

In this report the San Diego City Attorney concludes that substantial evidence exists that is consistent with a finding that, in 1996 and 1997, City and pension officials violated their fiduciary duty owed to the City of San Diego and the San Diego City Employees' Retirement System (SDCERS) in connection with the creation of a pension benefit and funding contract known Manager's Proposal 1 (MP-1).

There is also substantial evidence that these officials engaged in fraudulent and deceptive acts and practices in connection with the creation of hundreds of millions of dollars of pension benefits related to MP-1.

There is also substantial evidence that, in violation of Government Code § 1090, these officials held prohibited contractual interests in the pension benefits that they voted to create.

There is also substantial evidence that by offering to exchange and exchanging a thing of value with the pension board, these officials created, in MP-1, an illegal and unenforceable contract.

There is also substantial evidence that by creating and representing the terms of MP-1, then-City Manager Jack McGrory acted as a fiduciary to the City's pension plan participants and that by engaging in the acts and practices detailed in this report, he violated his fiduciary duty to those participants.

There is also substantial evidence that professionals providing expert services to both the City and the pension board members violated their duties of conduct and care in connection with the creation and implementation of MP-1.

There is also substantial evidence that in creating these unpaid-for pension benefits City and pension officials violated the liability limits of the City Charter and the State Constitution.

The legal remedies available to the City and the pension board will be discussed in detail in Interim Report No. 7.

II.

BACKGROUND

The San Diego City Attorney has issued five interim reports focusing on possible illegal acts by City officials in connection with the audit of the City's 2003 financial statement. The reports found as follows:

(1) In Interim Report No. 1 (January 14, 2005), regarding possible abuse, fraud, and illegal acts by San Diego City officials and employees, the City Attorney released evidence that the 2002 final report of the Mayor's Blue Ribbon Committee on City of San Diego Finances understated the severity of the City's pension fund liability by 318% or \$215 million.

(2) In Interim Report No. 2 (February 2, 2005), regarding possible abuse, fraud, and illegal acts by San Diego City officials, the City Attorney revealed substantial evidence consistent with a finding that the Mayor and Council authorized the issuance of certain City bond offerings and related disclosure documents that they knew to be false.

(3) In Interim Report No. 3 (April 9, 2005), regarding violations of State and local laws related to the SDCERS Pension Fund, the City Attorney concluded that City officials violated the California Constitution, State law, the San Diego City Charter, and the San Diego Municipal Code in causing the underfunding of the San Diego City Employees' Retirement System.

(4) In Interim Report No. 4 (May 9, 2005), regarding additional funding for outside professionals reviewing alleged illegal acts, the City Attorney questioned whether the Outside Professionals' Audit Committee could finish its work in an economical and timely manner and recommended that the Council not approve any additional funds for the Committee until a complete review of its scope of work had been conducted.

(5) In Interim Report No. 5 (May 18, 2005), regarding the legal status of the elected officers' retirement program, the City Attorney determined that the City Council violated the Charter's pension vesting rules when members passed an ordinance that granted benefits to elected officials who had not served for 10 years and who had not reached age 62.

III.

DISCUSSION OF FACTS

A. INTRODUCTION

On 21 June 1996, the San Diego employees' pension plan board of trustees adopted a radical benefit funding proposal made by then-City Manager Jack McGrory. The McGrory proposal was designed to relieve the City of its legal duty to pay into its pension plan the amounts needed to ensure that benefits would be paid promptly.¹ In exchange, City officials agreed to create hundreds of millions of dollars of new benefits that had no funding source.² This reduced-funding-for-increased-benefits agreement is referred to as Managers' Proposal No. 1 (MP1).

B. MCGRORY PROPOSAL: EXCHANGE VIOLATION OF CHARTER EXPENDITURE CONTROL LIMITS FOR VIOLATION OF STATE CONSTITUTIONAL PROMPT PAYMENT OF BENEFITS FUNDING REQUIREMENT

City officials, pension trustees, and plan participants must comply with the expenditure control provisions contained in the San Diego Charter.³ Pension board members administering the City's pension must require the City to pay for legally created benefits so that these benefits can be paid to retirees promptly.⁴ These two legal mandates frame and limit the City's ability to create pension benefits.

In 1996, City and pension officials acted outside these mandates by entering into MP-1. Under MP-1, these officials, led by McGrory and pension administrator Lawrence Grissom, agreed to increase pension benefits and to decrease pension benefit funding. This agreement, which was violative of both the City Charter and the State Constitution, when combined with a similar agreement that City officials entered into in 2002, has resulted in the worst financial crisis in modern San Diego history.

San Diego Charter § 99 prohibits the City from incurring "any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year unless the qualified electors of the City, voting at an election to be held for that purpose, have indicated their assent"⁵ California State Constitution

¹ Cal. Const. art. XVI, § 17(a).

² See 23 July 1996 Lexin Memorandum and City Attorney Interim Reports Nos 1-5; see City Attorney's Website.

³ San Diego Charter § 99.

⁴ Cal. Const. Art. XVI, § 17(a). See n. 1.

⁵ San Diego Charter § 99. See n. 3.

Article XVI, § 17(a) requires that the City's pension plan be administered "in a manner that will assure prompt delivery of benefits" to the participants and their beneficiaries.⁶

C. ORIGINS OF MP-1

MP-1 originated in a series of meetings among Mr. McGrory, Mr. Grissom, and pension board president Keith Enerson. A "Draft" and "Confidential" 29 February 1996 memorandum from Mr. McGrory to "Distribution" provided an "outline of the package we discussed with Keith [Enerson] and Larry [Grissom]." ⁷ This outline detailed a proposal that the City's pension plan funding level would not be set by actuarial determination⁸ but instead would be limited to "the lower bifurcated rate in FY 96."⁹ In exchange for this limitation of the City's pension contribution, benefits were to be increased:

3. WE PROVIDE THE ½ AND ¾ EMPLOYEE BENEFIT THAT WAS
AT COUNCIL

4. WE ELIMINATE THE DISABILITY INCOME OFFSET.

9. WE PROVIDE A 3 YEAR OPEN ENDED BUY BACK TO BE PAID, BOTH
EMPLOYEE AND CITY CONTRIBUTIONS, BY THE EMPLOYEE-THIS
WOULD BE A ONE TIME BENEFIT BUT COULD BE PAID BY ALLOWING
EMPLOYEES TO TRADE SOME % OF THEIR ANNUAL LEAVE AT
TERMINATION.

Obviously, in 1996, City officials were focused on increasing the money that they could take out of the pension plan beyond those amounts diverted from "surplus earnings." Their proposal was to continue to take money from the pension fund and beginning in 1997, to put less in by underfunding the pension benefits that they created. On 1 March 1996, pension administrator Mr. Grissom wrote a more extensive memorandum regarding a 26 February 1996 meeting that he had attended with Mr. McGrory and Mr. Enerson. In his memorandum Mr. Grissom acknowledges that the heart of their negotiations was the City's existing practice of diverting money from the pension plan to pay for non-pension purposes. This acknowledgement demonstrates that City officials had previously engaged in an unlawful practice of diverting funds from the pension system.¹⁰

⁶ Cal. Const Art. XVI, § 17(a). See n. 1.

⁷ February 1996 Jack McGrory memorandum to "Distribution."

⁸ San Diego Charter §§ 142 and 143 and Article XVI § 17(a) of the California Constitution require that the City's pension fund payment be determined by an actuary; see fn. 1.

⁹ 29 February 1996 Jack McGrory memorandum to "Distribution;" see n. 7.

¹⁰ See 16 September 2004 Report on Investigation the City of San Diego, California's Disclosures of Obligation to Fund the San Diego City Employees' Retirement System and Related Disclosure Practices 1996-2004 with Recommended Procedures and Changes to the Municipal Code pp. 31-34 (16 September 2004 Report). The money diverted from the pension funds were euphemistically referred to as "surplus

Mr. Grissom began his 1 March 1996 memorandum by alluding to the central role played by “undistributed earnings.” He then went on to describe the “package” that would allow the City to put less money into the system in exchange for creating new benefits. “I will start with reserve crediting of undistributed income since the rest of the package flows out of this.”¹¹ Mr. Grissom explained that the new unfunded benefits would solve the “perception” that the pension board was “giving the City a lot of money”:

What follows is a proposal for implementing the package that you Jack and I discussed on February 26. It is necessarily a little rough due to the time of constraints. I will start with reserve crediting of undistributed income since the rest of the package flows out of this.

1. Perception. It looks like the Board is “giving” the City a lot of money. This is, frankly, a political and negotiation issue. The negative perception should be at least partially offset by increasing benefits as discussed below.¹²

Mr. Grissom was understandably skeptical about the reaction of outside legal counsel to a package in which unfunded benefits would be exchanged for lowered funding. He knew that the plan would have to be carefully framed in order to get it past outside counsel:

2. Outside counsel. I have no idea whatsoever how outside counsel will react to this plan. We should consider this carefully and thoroughly strategize out [sic] approach.

Mr. Grissom brought home in no uncertain terms that funds diverted from surplus earnings into reserves directly increased the pension fund’s unfunded liability. He explained the ratio between increases in the system’s unfunded liability due to diversions of pension funds into reserve accounts and increases in the City’s contribution rate into the system to make up for the earlier diversions:

earnings” or “undistributed income.” These diverted pension funds were “transferred” to “reserves.” Funds held by the pension plan and all earnings thereon are required to be used so that benefits can be delivered promptly to plan participants. Diversions of surplus earnings are unlawful under the State Constitution and fiduciary laws. In *Board of Administration v. Wilson*, 52 Cal. App. 3d 1109, 1131-1137 (1997), the court held that vested state employee members of CalPERS have a contractual right to an actuarially sound retirement system; see City of San Diego Website.

¹¹ 1 March 1996 San Diego City Employees’ Retirement System Memorandum from Larry Grissom to Keith Enerson regarding “Proposed Retirement Package” p. 2.

¹² 1 March 1996 San Diego City Employees’ Retirement System Memorandum from Larry Grissom to Keith Enerson regarding “Proposed Retirement Package” p. 2. See n. 11.

3. Holding Stabilization Reserve outside valuation assets. This means that Rick does not count that amount as assets in the actuarial valuation. The net effect is to increase the System's unfunded liability. For each \$10 million in unfunded liability, the City contribution rate will increase approximately 0.13% all else being equal.

Although Mr. Grissom suggested that the diversions and the related increases in the City's future contribution rate be "capped" at \$75 million, he admitted that predicting the effect of the "package" on the level of future underfunding was "nearly impossible," thus undermining the parties' ability to set any caps on diversions or on the related future rate increases:

This is why I recommended capping this reserve at \$75 million, since that would mean an increase in the City Contribution rate of about 1%. Two factors mitigate the rate increase. First, while it is nearly impossible to predict with any accuracy, I don't think the reserve will get that high. Second, it is a question of trade-offs. At current payroll levels, 1% amounts to between \$4.5 and \$4.0 million, which is the maximum only if the reserve reaches it cap.¹³

In his 1 March 1996 memorandum, Mr. Grissom also estimated that under the MP-1 package, a "stabilization" of the City's rate of contribution into the pension system would be set in order to reduce the City's annual payment by at least \$5 million per year: "The City will be getting a reduction of at least \$5 million annually on its contribution cost for the next five years."¹⁴

According to his memorandum, pension system actuary Rick Roeder had already signaled that he was comfortable with the "concept," including the increase of diverted funds into the reserve accounts: "I have also discussed this concept with Rick [Roeder] and he is comfortable from an actuarial standpoint with this reserve."¹⁵

Mr. Grissom described in detail the predicament faced by the pension system that was caused both by past efforts to reduce the contribution rate that the City had to pay into the system and by the City's use of pension funds to pay for non-pension benefits. One factor in the predicament was the decision to use alternative methods for measuring the amounts due the pension fund from the City. Prior to 1996, the City and pension system officials had agreed to shift from the EAN method to the PUC computation

¹³ 1 March 1996 San Diego City Employees' Retirement System Memorandum from Larry Grissom to Keith Enerson regarding "Proposed Retirement Package" pp. 2-3. See n. 11.

¹⁴ 1 March 1996 San Diego City Employees' Retirement System Memorandum from Larry Grissom to Keith Enerson regarding "Proposed Retirement Package" p. 3. See n. 11.

¹⁵ 1 March 1996 San Diego City Employees' Retirement System Memorandum from Larry Grissom to Keith Enerson regarding "Proposed Retirement Package" p. 3. See n. 11.

method with the expectation that rates would be reduced. However, as Mr. Grissom stated in his memorandum, the actual outcome varied from the predicted, leading him to conclude that the system should return to the EAN method:

RATE STABILIZATION

The central recommendation to this discussion is to change from PUB back to EAN effective July 1, 1996. Rick has indicated that the EAN rate for the FY95 valuation (effective July 1, 1996) would be approximately 10.2%. The PUC rate for the FY 95 valuation is 9.2%, or a difference of 1%. When the conversion was made for rates effective July 1, 1992, the difference was 2.77%.

The analysis by the actuary of the time of conversion showed that PUC was cheaper in the beginning, but that, since PUC rates would increase slightly annual while EAN remains stable (all else being equal), the “lines will cross” around year 22 of a 30 year amortization period. The PUC rate will be higher than EAN at the end of 30 year amortization period. What has happened is that the gap has narrowed by 1.77% in only four years. If things keep going the way they have been, the lines will cross in the next 2 to 5 years, less than 10 years after implementation. At the end of the amortization period, PUC could logically be very significantly higher.¹⁶

The 1 March 1996 memorandum went on to describe the proposed “Implementation Plan,” in which the City’s contribution rates between fiscal year 1996 and fiscal year 2000 would be reduced below the actuarially required rate with a resultant temporary savings to the City of \$45 million.¹⁷ The Grissom memorandum then described the increased unfunded benefits that the City would agree to in order to offset the appearance that the pension system was “giving the City a lot of money”.¹⁸

¹⁶ 1 March 1996 San Diego City Employees’ Retirement System Memorandum from Larry Grissom to Keith Enerson regarding “Proposed Retirement Package” p. 3. See n. 11.

¹⁷ 1 March 1996 San Diego City Employees’ Retirement System Memorandum from Larry Grissom to Keith Enerson regarding “Proposed Retirement Package” p. 4. See n. 11.

¹⁸ 1 March 1996 San Diego City Employees’ Retirement System Memorandum from Larry Grissom to Keith Enerson regarding “Proposed Retirement Package” p. 2. See n. 11.

BENEFITS CHANGES

1. Elimination of the disability income offset. This is a win win. Since we are already increasing contributions to pay off the unfunded liability and we have established that any recovery under the presently structured plan will be minimal we are assuming 0 offset in our actuarial assumptions. This means that this is a cost free benefit.
2. Grant the Virginia Silverman purchase. Roll this into purchase of service changes described below.
3. Make pre 80 health insurance coverage a permanent benefit. Projected cost for FY 96 is \$622,400. Cost will decline in the future assuming continuation of current level of benefit since this is a closed group. Cost is built in to projections of total health insurance benefit.
4. Double 13th check amount for pre 80 retirees. Projected cost for FY 97 (FY 96 has already been paid) is \$571,000 based on those with received a 13th check for FY 96. Actual cost will be slightly less because this is a closed group and some will be gone by October.
5. Change purchase of service. My recommendation is as follows:
 - a. Keep refunds, probationary period, 1981 Plan waiting period, and Military & Veterans Code required military service intact.
 - b. Eliminate all other existing categories of purchase.
 - c. Replace with a program allowing any member to purchase up to 5 (3?) years of additional service any time or at retirement; Purchase cost to be calculated based on individual contribution rate including offset, City contribution rate, and current salary.
 - d. Purchase at time of retirement can be made using some form of negotiated credits for unused annual leave. ***
6. Increase general member formula.¹⁹

The purchase-of-service-credit benefit increase drew special mention from Mr. Grissom, who called it a “potentially great benefit.” Although he described problems associated with the amount a member would be allowed to pay, he dismissed all impediments and indicated that he already had outside legal counsel Bob Blum and pension system actuary Rick Roeder working on the problems: “There are always solutions. I have talked to Bob Blum and Rick [Roeder] and we are working on a variety of ideas . . . [w]orking with Rick [Roeder] on design and costs. I may not have time to offer a good solution by March 5, but will shortly thereafter.”²⁰

¹⁹ 1 March 1996 San Diego City Employees’ Retirement System Memorandum from Larry Grissom to Keith Enerson regarding “Proposed Retirement Package” p. 5. See n. 11.

²⁰ 1 March 1996 San Diego City Employees’ Retirement System Memorandum from Larry Grissom to Keith Enerson regarding “Proposed Retirement Package” p. 6. See n. 11.

According to Mr. Grissom, Mr. McGrory agreed to “go to the Council and recommend that they direct the Manager and Board to study and report back” with regard to certain aspects of the plan. Mr. Grissom then ends his memorandum with a summary of the MP-1 package:

This is a good plan. It gives the city nearly 445 million of rate relief over the next 5 years. . . . It provides an equitable distribution of earnings while providing a measure of protection. It solves some gnawing administrative problems. It should provide a sufficient ratio of increased benefits and costs to satisfy fiduciary counsel. It does not give safety members and retirees, particularly thereafter, all that they might want, but it does represent a significant improvement.²¹

On 19 March 1996, 18 days after Mr. Grissom recorded Mr. McGrory’s agreement to take parts of the proposed MP-1 package to the City Council, the Council held a closed session on meet and confer issues.²² The docket for the meeting reflects a closed session for the purpose of labor negotiations: “Conference with Labor Negotiator, Pursuant to Government Code § 54957.6.” The City’s negotiators were identified as Jack McGrory, Bruce Herring, Cathy Lexin, and Bill Lopez. Three of the City’s four unions, AFSME Local 127, Firefighters Local 145, and the San Diego Police Officers Association, were also identified.²³ The minutes, which indicate that Mr. McGrory and Mr. Herring were present, list the eighth item on the agenda as “Meet and Confer.”²⁴ As reflected in the minutes, the City Clerk employee keeping the minutes left the room when the meet and confer issue was reached: “Recorder Skelley left at 9:57 a.m. and the Council continued in Closed Session for meet and confer until 10:02 a.m.”²⁵

On 28 March 1996, Bruce Herring faxed a version of the MP-1 package (“draft 1996 SDCERS Plan Revision Outline”) to attorney Jeffrey S. Leavitt, a partner in the Jones, Day Reavis & Pogue law firm.²⁶ The proposal was the result of discussions between the plan administrator of the San Diego City Employees’ Retirement System

²¹ 1 March 1996 San Diego City Employees’ Retirement System Memorandum from Larry Grissom to Keith Enerson regarding “Proposed Retirement Package” p. 7. See n. 11.

²² 1 March 1996 San Diego City Employees’ Retirement System Memorandum from Larry Grissom to Keith Enerson regarding “Proposed Retirement Package” p. 7. See n. 11.

²³ 19 March 1996 San Diego City Council Closed Session Docket.

²⁴ 19 March 1996 San Diego City Council Closed Session Agenda.

²⁵ 19 March 1996 San Diego City Council Closed Session Minutes p. 3.

²⁶ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring re: “Fiduciary Aspects of Plan Revisions.” A 2 April 1996 letter from Jeffrey S. Leavitt to Bruce Herring confirms the City’s retention of the Jones Day law firm “regarding the fiduciary and federal tax implications of the proposed revisions to benefits for City employees under the San Diego City Employees’ Retirement System.”

(SDCERS or the System) and the City Manager.²⁷ At the time this proposal was “being discussed with labor organizations representing the City’s employees as part of the [then] current meet and confer process.”²⁸

The proposal as of 28 March 1996, was described by the City’s outside counsel as follows: First, it included various changes in benefits, most of which constituted benefit increases.²⁹ Second, it contained a change in the method of providing medical benefits.³⁰ Third, the final portion of the proposal concerned rate stabilization and changes to reserves.³¹ The proposal also included a statement that there would be no changes in actuarial assumptions or actuarial methodology that could conceivably effect contribution rates prior to July 1, 2000.³² From the City’s point of view, the rate stabilization and changes to reserves were the quid pro quo for the proposed benefit improvements.³³

On the 9 April 1996 City Council closed session agenda, the fifth item was “Meet and Confer.” Minutes of the session indicated that Mr. McGrory was present. They further indicated that at 9:55 a.m., the closed session discussion began again absent a City Clerk minute taker: “This portion of the Closed Session Meeting halted at 9:55 a.m. Council discussion followed pertaining to the Meet and Confer issues.”³⁴

An 11 April 1996 memorandum from Deputy City Attorney John M. Kaheny regarding “Closed Session Agenda Items for April 16, 1996” had recorded that labor negotiations were to take place at the 16 April 1996 closed session.³⁵ The memorandum identified the City’s negotiators as Jack McGrory, Bruce Herring, Cathy Lexin, and Bill Lopez.

²⁷ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring re: “Fiduciary Aspects of Plan Revisions” p. 1. See n. 26.

²⁸ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring re: “Fiduciary Aspects of Plan Revisions” p. 1. See n. 26.

²⁹ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring re: “Fiduciary Aspects of Plan Revisions” p. 4. See n. 26.

³⁰ The medical benefits issues are not discussed in this report.

³¹ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring re: “Fiduciary Aspects of Plan Revisions” p. 5; see n. 26.

³² 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring re: “Fiduciary Aspects of Plan Revisions” p. 4; see n. 26.

³³ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring re: “Fiduciary Aspects of Plan Revisions” pp. 4-5; see n. 26.

³⁴ 9 April 1996 San Diego City Council Closed Session Minutes p. 3.

³⁵ 11 April 1996 Closed Session Item Memorandum from Deputy City Attorney John M. Kaheny to City Clerk p. 2.

The 16 April 1996 City Council closed session agenda indicated that the eighth item was "Meet and Confer."³⁶ Minutes of the session indicated that Mr. McGrory and Mr. Herring were present. They further indicated that at 10:17 a.m., the City Council's closed session halted and that Council continued with a discussion about meet and confer.³⁷ At 2:00 p.m., the Council reconvened to continue meet and confer discussions.³⁸ Again, apparently no City Clerk employee kept minutes of these discussions.

On 23 April 1996 San Diego City Attorney John Witt issued a report to the Board of Administration of the San Diego City Employees' Retirement System.³⁹ In the report City Attorney Witt recorded the fact that on 18 April 1996, pension administrator Lawrence Grissom told the pension board that they would convene in a special meeting on 30 April 1996. The purpose of the meeting was to discuss the MP-1 proposal offered by City Manager Jack McGrory.⁴⁰ City Attorney Witt indicated that he had read MP-1 and that it concerned "benefits improvements, contribution rates, and reserve accounting."⁴¹ Mr. Witt went on to describe what he considered to be a personal conflict of interest and to state that he would not be advising the pension board on MP-1:

I have reviewed the Manager's proposal. It concerns benefit improvements, contribution rates and reserve accounting. With my concurrence, the City Manager has retained the services of outside legal counsel to assist him with the fiduciary implications of this proposal. The City Manager has also retained the services of an outside actuary.

In accordance with Rule 7.20, Rules of the Retirement Board of Administration, I am also advising you to seek the services of outside fiduciary counsel to assist you in reviewing the Manager's proposal. In my view, this proposal raises important fiduciary considerations which must be fully examined as part of your decision-making process. I am uncomfortable in providing you this needed fiduciary guidance for several reasons.

First, I will be retiring after the conclusion of my present term in office. The Manager's proposal involves proposed benefit increases which

³⁶ 16 April 1996 San Diego City Council Closed Session Agenda.

³⁷ 16 April 1996 San Diego City Council Closed Session Minutes p. 3.

³⁸ 16 April 1996 San Diego City Council Closed Session Minutes p. 3. See n. 37.

³⁹ 23 April 1996 City Attorney Report to the Board of Administration for the San Diego City Employees' Retirement System.

⁴⁰ 23 April 1996 City Attorney Report to the Board of Administration for the San Diego City Employees' Retirement System p. 1. See n. 39.

⁴¹ 23 April 1996 City Attorney Report to the Board of Administration for the San Diego City Employees' Retirement System, p. 1. See n. 39.

substantially enhance my retirement benefits. Although, I realize that I do not have a legal conflict of interest, I am very concerned about the appearance of a conflict of interest. Second, the proposal addresses other significant benefit enhancements, future contribution rates, a change in the funding method (a return to EAN from PUC), and other changes with the Reserves maintained and administered by the Board. As both the legal advisor to the Board and the City Manager, my concern over the appearance of a conflict of interest in this sensitive and volatile area is exacerbated.

Mr. Witt then described the possibility of litigation between the pension board and the City Manager as an additional reason for his decision to withdraw from representation. This 23 April 1996 memorandum underscores the significant changes that were being considered by the Council, the City Manager, and the pension board. At this key point the City Attorney should have stepped forward and stopped the proposal to exchange the creation unfunded benefits for a reduction in the constitutionally mandated funding.

An 18 April 1996 memorandum regarding closed session items that was authored by Deputy City Attorney John M. Kaheny identified a conference with the City's labor negotiators as an item to be discussed at the 23 April 1996 closed session.⁴² It also named the City's negotiators as Jack McGrory, Bruce Herring, Cathy Lexin, and Bill Lopez. The 23 April 1996 Closed Session Agenda identified "Meet and Confer" as the second of two items to be discussed.⁴³

The 23 April 1996 closed session docket identified a conference with the City's labor negotiator as the second and last item to be discussed at the closed session on 23 April 1996. The City's negotiators were identified as Jack McGrory, Bruce Herring, Cathy Lexin, and Bill Lopez.⁴⁴ The minutes for the 23 April 1996 closed session indicate that the City Council continued with the meet and confer items until 10:00 a.m. The minutes reflect that Jack McGrory and Bruce Herring were in attendance at the closed session.⁴⁵ Again, apparently no City Clerk employee kept minutes of these meet and confer discussions.

The essential features of what was to become MP-1 were set forth in a draft "Concept Overview" prepared by Mr. McGrory and dated 29 April 1996. Stressing that "substantial financial implications to the City compel that certain actions occur in time

⁴² 18 April 1996 Closed Session Item Memorandum from Deputy City Attorney John M. Kaheny to City Clerk.

⁴³ 23 April 1996 San Diego City Council Closed Session Agenda.

⁴⁴ 23 April 1996 San Diego City Council Closed Session Docket.

⁴⁵ 23 April 1996 San Diego City Council Closed Session Minutes p. 1.

for Fiscal Year 1997 budget decisions,”⁴⁶ Mr. McGrory proposed reducing the City’s contribution rate to a fixed amount below that required by actuarial computation. He did so despite the fact that the plan beneficiaries have a contractual right to an actuarially sound fund. *Claypool v. Wilson*, 4 Cal. App. 4th 646, 676 (1992). In addition under San Diego Charter § 143, the City is required to make pension plan contribution rates as set by an actuary.

The 29 April 1996 version of MP-1 represented a two-part increase in the pension deficit. First, there would be an increase in six pension benefits, the costs of which would be added to the long-term pension deficit. Second, there would be a significant reduction in the amount that the City would be required to pay into the pension system for benefits already adopted.⁴⁷ The combination of increased unpaid-for benefits and decreased contributions for benefits already created eventually led to the \$1.7 billion deficit facing the pension system as of 15 June 2005.⁴⁸

Two of the proposed benefits in the 29 April 1996 Concept Overview involved the purchase of service credits. Under this proposed program, all employees would be permitted to buy up to five years of service credits for “an amount, including interest, determined by the Board in such manner and at such time as the Board may by rule prescribe.”⁴⁹ In addition those employees with 15 or more years of creditable service as of 1 July 1996, would be permitted to “purchase up to five (5) years of service . . . at a discounted rate subject to the individual employee’s IRS 415 limitations.”⁵⁰ The total costs of the proposed discount for the service credit program, which were not to exceed \$6 million,⁵¹ were to be paid from “surplus earnings.”⁵² The final version of MP-1, dated 23 July 1996, stated that employees were to pay “full cost” for the purchase of service credits.⁵³ The pension system’s 2004 actuarial report shows that 2900 plan participants purchased over 13,000 years of service credits. The system actuary has

⁴⁶ 29 April 1996 City Employees Retirement System “Concept Overview” p. 1-4.

⁴⁷ 29 April 1996 City Employees Retirement System “Concept Overview” p. 1. See n. 46

⁴⁸ Although the pension system actuarial report for the fiscal year ending 30 June 2004, estimated the pension deficit at \$1.4 billion, work done by the City’s outside auditor, KPMG, has caused the estimated shortfall to be put at closer to \$1.7 billion.

⁴⁹ 29 April 1996 City Employees’ Retirement System “Concept Overview” p. 2. See n. 46.

⁵⁰ 29 April 1996 City Employees’ Retirement System “Concept Overview” p. 2; IRS Code § 415 provides for dollar limitations on benefits and contributions under qualified retirement plans. It also requires that the IRS Commissioner annually adjust these limits for cost of living increases. See n. 46.

⁵¹ 29 April 1996 City Employees’ Retirement System “Concept Overview” p. 2; IRS Code § 415 provides for dollar limitations on benefits and contributions under qualified retirement plans. It also requires that the IRS Commissioner annually adjust these limits for cost of living increases. See n. 46.

⁵² 29 April 1996 City Employees’ Retirement System “Concept Overview” p. 2. See n. 46.

⁵³ 23 July 1996 memorandum from Cathy Lexin to Larry Grissom p. 2, 6; see fn 2.

estimated that these 13,000 years of service credits were sold at a cost to the City of in excess of \$100 million.⁵⁴

Another benefit increase proposed in the 29 April 1996 Concept Overview was the Deferred Retirement Option Plan (DROP). Under the DROP program employees would receive their annual salary and their retirement benefit with 8% interest on the retirement portion of their DROP takings. The 29 April 1996 version of MP-1 provided that DROP “would have no cost impact to the City or CERS.”⁵⁵ Employees could “participate in this program subject to management approval, and [could] be terminated by Management at the end of three (3) years.”⁵⁶

Contrary to the earlier assessment, it is now estimated that the DROP program does have a cost effect on CERS.⁵⁷ The power to terminate the program after three years, contained in the 29 April 1996 Concept Overview, was changed in the final version: “If the cost impact to the City or CERS is greater than the savings, the City agrees to meet and confer to impasse prior to imposing any changes in the DROP Plan.”⁵⁸ Other benefit increases in the City Manager’s 29 April 1996 Concept Overview included both increases in the percentage formula used to calculate general employees’ per-year pension benefits and an increase for industrial disability. The costs of the increase in the former were to be paid “from any surplus undistributed excess earnings.”⁵⁹ The creation of pension benefits with no or an inadequate funding source violated San Diego Charter § 99, the City’s expenditure control provision that prohibits the incurring of “any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year” unless approved by the voters.⁶⁰

While proposing to increase the pension deficit by creating new unpaid-for benefits, in the 29 April 1996 Concept Overview the City Manager also proposed an increase in the deficit that would result from decreasing the City’s payments into the pension fund to amounts below those needed to pay for benefits already adopted. These decreased payments took two forms. The first proposed by Mr. McGrory was a reduction, beginning in fiscal year 1997, in the City’s pension contribution rate. The second reduction was caused by diversions of pension funds already in the pension

⁵⁴ The system actuary first estimated the cost of past service liability to be in excess of \$120 million. After the City Attorney published this estimate, the system actuary reduced his cost estimate.

⁵⁵ 29 April 1996 City Employees’ Retirement System “Concept Overview” p. 3. See n. 46.

⁵⁶ 29 April 1996 City Employees’ Retirement System “Concept Overview” p. 3. See n. 46.

⁵⁷ The CERS actuary has estimated the cost at several million dollars.

⁵⁸ 23 July 1996 memorandum from Cathy Lexin to Larry Grissom p. 6. See n. 2.

⁵⁹ 29 April 1996 City Employees’ Retirement System “Concept Overview” p. 3. See n. 46.

⁶⁰ San Diego Charter § 99. See n. 3.

system. The pension board allowed both to occur in violation of Article XVI § 17 of the California Constitution.⁶¹

Under the 29 April 1996 Concept Overview, the City would pay 7.08% of payroll in fiscal year 1996 and 7.33% in 1997.⁶² The City would then increase the rate by “0.50% each year until the rate paid reaches the EAN calculated rate.”⁶³ The City was to make contributions at agreed-upon rates through fiscal year 2000; these rates would be in amounts substantially below those required under actuarial computations. This proposal to make payments at agreed upon levels and not at rates determined by an actuary violated the City Charter, which requires contributions at rates “certified by the actuary.”⁶⁴

The 29 April 1996 proposal stated that if the pension system’s assets became less than 80% of the pension system’s liabilities, the plan would “sunset the year following the actuarial valuation which show [sic] this funded ratio.”⁶⁵ Under this plan no changes in actuarial assumptions were to occur prior to July 2000:

There will be no changes in actuarial assumptions or actuarial methodology which would conceivably impact contribution rates prior to July 1, 2000. If the CERS Board feels its fiduciary responsibility requires a change in actuarial assumption prior to that date, this plan will sunset immediately at that time. Any additional benefits granted herein may be eliminated prospectively.⁶⁶

Although the proposal suggested that various reserve accounts be created, the source of funds for the new accounts was to be pension fund assets. Despite discussions about them, these accounts played no significant role in the implementation of MP-1.⁶⁷ However, they did play a significant role in creating the false impression that funds were available to pay for the increased benefits. The source of funds that were to be placed into the various reserve accounts had a common origin -- trust fund assets. In other

⁶¹ Cal. Const. Art. XVI, § 17(a). See n. 1.

⁶² These proposed contribution rates were blended -- this is, the rates paid for general member employees were averaged with those paid for public safety employees.

⁶³ The contribution rate paid by the City in 1996 was the PUC rate, which tended to require lesser payments into the plan in the early years and much greater amounts later. Under the EAN method the payments were level and remained stable year to year.

⁶⁴ San Diego Charter § 143; see n. 8.

⁶⁵ 29 April 1996 City Employees’ Retirement System “Concept Overview” p. 4; see n. 46.

⁶⁶ 29 April 1996 City Employees’ Retirement System “Concept Overview” p. 4; see n. 46.

⁶⁷ 16 September 2004 Report pp. 53-56. Although the reserve accounts did not play a major role in the implementation of MP-1, they did serve as a basis for issuing false and misleading statements to the investment community; see City of San Diego Website.

words, Mr. McGrory proposed using trust fund assets to pay for new benefits when the trust funds were already in the pension system and already belonged to the plan participants.

City Manager McGrory made clear that benefit increases proposed under the 29 April 1996 plan were contingent and dependent upon the pension board agreeing to accept less than the actuarially required contribution rates from the City: "The interrelationship of these various issues to each other necessitates that the entire proposal be considered and acted upon concurrently."⁶⁸

On 29 April 1996, in his capacity as outside counsel for the City of San Diego, Jeffrey S. Leavitt, an attorney with the Cleveland, Ohio law firm of Jones, Day, Reavis & Pogue, wrote a six-page letter to Deputy City Manager Bruce Herring addressing the fiduciary implications of MP-1.⁶⁹ Mr. Leavitt concluded that the City was not acting as a fiduciary "with respect to the members of the System when revising benefits."⁷⁰ He did, however, find that the City Manager, the City Auditor and Comptroller, and the City Treasurer are fiduciaries when acting as members of the pension board.⁷¹

The implications of City Manager Jack McGrory acting as a fiduciary to the pension plan participants while simultaneously serving as a City fiduciary in connection with MP-1, raises a significant legal issue that was not addressed directly in Mr. Leavitt's 29 April 1996 letter. Mr. Leavitt also did not address the related legal question of Mr. McGrory's duty as a City fiduciary. Mr. Leavitt should have analyzed whether Mr. McGrory was a fiduciary to the pension plan in light of the role that Mr. McGrory was playing in reshaping the pension plan's contribution rates and reserves. Courts have uniformly held that the test for determining if an individual in Mr. McGrory's position qualifies as a fiduciary is whether the "individual exercises . . . authority or control over the plan or its assets."⁷² Mr. McGrory was an agent of the pension plan's sponsor, the

⁶⁸ 29 April 1996 City Employees' Retirement System "Concept Overview" p. 1. See n. 46.

⁶⁹ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring; the letter was purportedly provided to Mr. Herring by Mr. Leavitt "as counsel to the City with the understanding that neither Jones, Day, Reavis & Pogue nor I are assuming any professional responsibility to any other person whatsoever." See n. 26.

⁷⁰ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 2. See n. 26.

⁷¹ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 2 (n. 5). See n. 26.

⁷² See *When is Employer, Labor Union, Affiliated Entity or Person or Pension or Welfare Plan 'Fiduciary' within meaning of §3(21)(A)(i) or (III) or Employee Retirement Income Security Act of 1974* 178 A.L.R. Fed 129; see also, *Pension Ben. Guar. Corp. v. Solmsen*, 671 F. Supp. 983 (E.D.N.Y. 1987) (sponsor fiduciary under pension plan); *Schwartz v. Interfaith Medical Center*, 715 F. Supp. 1190 (E.D.N.Y. 1989) (employer acted in fiduciary capacity); *Ches v. Archer*, 827 F. Supp. 159 (W.D.N.Y. 1993) (unresolved factual question about whether corporate officers acting as fiduciaries); *Hanley v. Giordano's Restaurant, Inc.*, 1995 WL 442143 (S.D.N.Y. 1995); *NYSA-ILA Medical & Clinical Services Fund v. Catucci*, 60 F. Supp. 2d 194 (S.D.N.Y. 1999).

City of San Diego. The agent of a plan sponsor can become a fiduciary by exercising any authority or control respecting management or disposition of plan assets. 29 U.S.C. § 1002(21)(A)(i); *Kendal Corp. v. Inter-County Hospitalization Plan, Inc.*, 771 F. Supp. 681 (E.D. Pa. 1991); *Landy v. Air Line Pilots Ass'n Int'l, AFL-CIO*, 901 F.2d 404 (5th Cir. 1990). Thus Mr. McGrory, as an architect of MP-1, may have, as to the particular tasks and issues contained therein, acted as a fiduciary to the pension plan participants. See *Spann v. Chicago Physicians II, P.C.*, 2000 WL 263976 (N.D. Ill. 2000) (failure of employer to perform duty related to pension plan); see also, *When is Employer, Labor Union, Affiliated Entity or Person, Or Pension or Welfare Plan 'Fiduciary' Within Meaning of §3(21)(A)(i) or (iii) of Employee Retirement Income Security Act of 1974*, 178 A.L.R. Fed. 129 (2005).

At the same time when he may have acted as a fiduciary to the pension plan, Mr. McGrory was clearly and certainly acting as fiduciary to the City of San Diego. Mr. Leavitt mentioned that the "City Council represents and is responsible to the voters and taxpayers."⁷³ It is universally agreed that local government officers owe their government and the people of their locality a fiduciary duty of the highest possible fidelity and of the greatest skill and diligence in their work, of which they are capable. Osborne, Reynolds, M. Jr., *Handbook of Local Government Law* (2d ed. 2001); see *Terry v. Bender*, 143 Cal. App. 2d 198 (1956); *People v. Sullivan*, 113 Cal. App. 2d 510 (1952); see also *Pharmacare v. Caremark*, 965 F. Supp. 1411 (D. Haw. 1996); *United States v. Sawyer*, 239 F.3d 31 (1st Cir. 2001) (citizens entitled to honest government services at the local level). These dual fiduciary roles and their legal implications will be discussed *infra*.

In his 29 April 1996 opinion, Mr. Leavitt does not address whether the City's representatives were acting on behalf of the City or of the pension plan. Instead, he concludes that "as settler, the City should not need to be concerned about the fiduciary implications of these proposals [MP-1]." Thus he avoided analyzing whether the City Manager and City Council were directing the City's pension board representatives to favor the City over pension plan participants. If they were doing so, a key issue would have been whether the City was acting as a fiduciary in connection with the plan to raise the system's deficit in order to allow the City to reduce the rate of its pension contributions. In his opinion Mr. Leavitt cites, but does not discuss, the case of *NLRB v. Amax*, 453 U.S. 322 (1981).⁷⁴

In the *Amax* case the United States Supreme Court found that the fiduciary provisions of federal pension trust law (the Employee Retirement Income Security Act or ERISA) "were designed to prevent a trustee from being put into a position where he has dual loyalties, and therefore, he cannot act exclusively for the benefit of a plan's

⁷³ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 2. See n. 26.

⁷⁴ Mr. Leavitt cites the *NRLB v. AMAX* case for the proposition that when the employer's representatives serve on pension boards, they act on behalf of the pension board, not of the employer. However, the case also should have alerted Mr. Leavitt to the legal problems that arise when these pension board members act to advance the employer's interest at the expense of pension participants.

participants and beneficiaries.” *NRLB v. Amax*, 453 U.S. at 334. According to the court in *Amax*,

The management-appointed and union-appointed trustees do not bargain with each other to set the terms of the employer-employee contract; they can neither require employer contributions not required by the original collectively bargained contract, nor compromise the claims of the union or the employer with regard to the latter’s contribution. *NRLB v. Amax*, 453 U.S. at 336. (Emphasis added.)

Despite the clear warning contained in *Amax*, the facts and circumstances show that such bargaining was going on between the board’s management and labor representatives in connection with the consideration and ultimate adoption of MP-1. This reality was memorialized in writing by pension trustee John F. Casey, who complained at the time that the board, in having to deal with MP-1, was being placed in the position of a negotiator:

With respect to the City Manager’s request for benefits and changes to the retirement system, I have serious concerns that the Board action of June 21, 1996, is flawed.

The proposal as submitted by the Manager, i.e., a benefit increase for a reduction in actuarial rates, placed the Board in the position of negotiator. I submit that the Board function is to administer the benefits granted by the plan sponsor and not negotiate what the benefits should be with the plan sponsor. There is no authority for the Board to engage in this activity.⁷⁵

Pension trustees “bargain[ing] with each other to set the terms of the employer-employee contract,” the very behavior condemned in *Amax*, was in play during the Spring of 1996 as board members grappled with MP-1. Moreover, it appears that pension board members who were also City employees were placed in a conflict over whether to act “for the sole benefit of the beneficiaries of the fund.” *NLRB v. Amax*, 453 U.S. at 337. Again, the issue of whether the fact that the City’s representatives on the pension board were negotiating benefits on behalf of the City violated their fiduciary duties to the pension system was not directly raised in Mr. Leavitt’s opinion letter of 29 April 1996.

However, Mr. Leavitt did discuss features of the fiduciary issues raised by MP-1. After categorizing “the parties to the plan revision process,”⁷⁶ he found that pension board members had a trust duty to pension plan members.⁷⁷ He also found that labor

⁷⁵ 16 July 1996 memorandum from John Casey to Fiduciary Counsel via Retirement Administrator.

⁷⁶ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 1. See n. 26.

⁷⁷ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring pp. 1-2. See n. 26.

organizations representing City employees “should not be fiduciaries under the System with respect to SDCERS members.”⁷⁸ In addition Mr. Leavitt determined that California State Constitution (Article XVI §17) “subjects public pension systems to the law of trusts”⁷⁹ and acknowledged that the “solely in the interest” and “exclusive purpose” language contained therein “represents the trustee’s common law duty of loyalty.”⁸⁰ He then admitted that pension board members have “a duty to deal fairly and in good faith with the members of SDCERS.”⁸¹

Then at this point in his opinion, Mr. Leavitt turned California employee pension trust law on its ear. He found that “the duty of loyalty set forth in the Constitution does not automatically preclude acts which incidentally benefit persons other than members of the System.”⁸² However, the reduction in the City’s contribution rate called for a substantial, not incidental, reduction in the City’s rate of contribution. In *Board of Administration v. Wilson*, 52 Cal. App. 4th 1109, 1118 (1997), “in arrears” financing of the State pension fund by which the California Legislature attempted a six-month delay in payments to the fund was found to be “an unconstitutional impairment of contract.” *Board of Administration*, 52 Cal. App. 4th at 1118.

Mr. Leavitt knew that both the reduction in the City’s pension contribution rate, which was euphemistically called “rate stabilization,” and changes in the plan’s reserves were, from the City’s point of view, “the *quid pro quo* for the proposed benefit improvements.”⁸³ Nonetheless, Mr. Leavitt opined that the City “should not need to be concerned about the fiduciary implications of these proposals.”⁸⁴ He was saying, in other words, that despite the fact that the City was paying a *quid pro quo* in new benefits to pension board members in exchange for a reduction in the actuarially required contribution rates, no breach of fiduciary duties by the City occurred. Even if this assessment were true and the City were not acting as a fiduciary of the pension plan, the proposal certainly raised serious issues about whether the City was inducing board members to violate their fiduciary duties by lowering the contribution rate and disconnecting the actuary from the rate setting process. See *Reich v. Hall Holding Co.*, 990 F. Supp 955 (N.D. Ohio 1998); *Williams v. Wright*, 783 F. Supp. 1392 (S.D. Ga. 1992); *Schaefer v. Arkansas Medical Soc.*, 853 F.2d 1487 (8th Cir. 1988); *Varity Corp. v. Home*, 516 U.S. 489 (1996).

⁷⁸ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 2. See n. 26.

⁷⁹ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 3. See n. 26.

⁸⁰ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 3. See n. 26.

⁸¹ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 4; Mr. Leavitt cited *Hittle v. Santa Barbara County Employees Retirement Association*, 29 Cal. 3d 374, 392 (1985) and *Symington v. Albany*, 5 Cal. 3d 23, 33 (1971). See n. 26.

⁸² 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 4. See n. 26.

⁸³ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 5. See n. 26.

⁸⁴ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 5. See n. 26.

Moreover, in communicating the terms of the proposed changes, the City was acting as a fiduciary. Thus when City officials, like City Manager Jack McGrory, represented that the costs of the new benefits would be paid for with “surplus earnings,” they were acting as fiduciaries to the plan participants, and when Mr. McGrory stated that the City would be able to reach full actuarial funding by increasing the rate of contributions into the plan by 0.50% after reducing the rate of contributions below those actuarially required, he was acting a fiduciary to the plan participants. See *Devlin v. Empire Blue Cross and Blue Shield*, 274 F.3d 76 (2d Cir. 2001); *Degnan v. Publiker Industries, Inc.*, 42 F. Supp. 2d 113 (D. Mass. 1999); *Anderson v. Resolution Trust Corp.*, 66 F.3d 956 (8th Cir. 1995); *Dall v. Chinnet Co.*, 201 F. 3d 426 (1st Cir. 1999). Again, this issue was not addressed by Mr. Leavitt, and again, Mr. Leavitt was incorrect when he said that the City need not be concerned about the fiduciary implications of these proposals.⁸⁵

In his 29 April 1996 opinion letter, Mr. Leavitt also argued that in satisfying their fiduciary duties, board members should consider “the Proposal as a whole rather than any individual component of the Proposal that is subject to this standard.”⁸⁶ Mr. Leavitt argued that the pension board should consider the funding-related changes as part of an overall program of plan revisions that would be advantageous from the perspective of the members. Again, Mr. Leavitt ignored the fact that pension board members were being asked to negotiate benefits as part of the meet and confer process and to trade off new pension benefits for a relaxation of the City’s contribution rate. On its face, this plan violated the role of the pension board. *NLRB v. Amax*, 453 U.S. 322 (1981).

Mr. Leavitt did admit that the MP-1 provision that no changes in actuarial assumptions or actuarial methodology would occur if they would conceivably affect contribution rates prior to July 1, 2000, “may raise fiduciary concerns.”⁸⁷ This provision violated the fundamental principle that guarantees plan participants “a contractual right to an actuarially sound retirement system.” *Board of Administration*, 52 Cal. App. 4th at 1118. Mr. Leavitt’s assertion that disconnecting the actuary from the process to be followed in setting the funding needs of the City’s pension system was thus in error. He suggested that it would be preferable for the proposal to provide the City with “acceptable alternatives” if the board had to “change actuarial assumptions or methodology prior to July 1, 2000.”⁸⁸ This advice is more akin to aiding the scheme than to offering cautionary legal advice. Mr. Leavitt failed to provide the City needed professional services with the skill, prudence, and diligence that an ordinary and reasonable lawyer would use under similar circumstances. California Civil Instruction (Standard of Care §600).

⁸⁵ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 5. See n. 26.

⁸⁶ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 5. See n. 26.

⁸⁷ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 5. See n. 26.

⁸⁸ 29 April 1996 letter from Jeffrey S. Leavitt to Deputy City Manager Bruce A. Herring p. 5. See n. 26.

On 2 May 1996 City Manager Jack McGrory presented MP-1 to the pension board. In doing so, he represented both that “the City has been working to resolve various problems facing the Retirement System and related benefit problems”⁸⁹ and that “it has become difficult for the City to work with the System’s fluctuating rates.”⁹⁰ It was not so much a question of fluctuating rates as an increase in the pension’s funding deficit. The unfunded liability in the pension fund had gone up from \$41.3 million in 1993 to \$104 million in 1995, a 153% increase.⁹¹ Mr. McGrory was dealing with a growing unfunded liability caused by the diversion of funds from the plan and by plan mismanagement.⁹²

Board member John Casey raised several red flags about the proposal:

Mr. Casey stated that a similar proposal had been brought forward last year, and after expending a significant amount of money, the Board was advised by outside fiduciary counsel that they could not move forward with the City’s proposal. He strongly stated that he did not want this to occur again. Additionally, he questioned why Mr. Wyatt’s firm would not be used when they are already familiar and have been educated about our system.⁹³

Board President Enerson, who had attended the 26 February 1996 meeting with Mr. Grissom and Mr. McGrory where MP-1 had been hatched, admitted that he personally directed that another lawyer be retained to replace Mr. Wyatt:

Mr. Enerson responded that the Board had been dissatisfied with the timeliness of receiving legal opinions from that firm and their lack of responsiveness to this Board. Mr. Enerson stated that because of these reasons, he had directed Staff to contact Attorney Dwight Hamilton, who had provided the Board with a fiduciary presentation at their Strategic Planning Workshop.⁹⁴

Mr. McGrory’s 2 May 1996 Concept Overview is included in the SDCERS 2 May 1996 board meeting minutes. According to the Concept Overview:

⁸⁹ 2 May 1996 SDCERS Retirement Board of Administration Special Meeting p. 1.

⁹⁰ 2 May 1996 SDCERS Retirement Board of Administration Special Meeting p. 1. See n. 89.

⁹¹ 1994 SDCERS Annual Actuarial Valuation 2004; see fn 48.

⁹² See 16 September 2004 Report p. 31 et seq. See n. 10.

⁹³ See 16 September 2004 Report p. 3; Mr. Casey was referring to Mr. Joseph Wyatt’s law firm Morrison and Foerster. The firm had previously advised against a program that had some of the elements contained in MP-1. Mr. Casey raised an implied concern that Mr. Wyatt was set aside in favor of another lawyer who would under an opinion supporting MP-1. See n. 10.

⁹⁴ 2 May 1996 SDCERS Retirement Board of Administration Special Meeting p. 3. See n. 89.

The City Manager's proposal is being reviewed by outside fiduciary counsel engaged through the City Attorney's Office and has been presented to the CERS Board's actuary for his review and advice to the Board. All proposed changes are conditioned upon and subject to final approval by fiduciary counsel, City Council approval, Retirement Board approval, vote of plan participants, and confirmation of cost estimates by the System's actuary.⁹⁵

The MP-1 proposal described in the 2 May 1996 Concept Overview reflected the plan changes from the 28 March 1996 and the 29 April 1996 versions. First, the cost to purchasers of past service credits was set at the "full cost of such service."⁹⁶ Second, the 29 April 1996 version of MP-1 had provided that any change made by the pension board in the actuarial assumptions affecting the City's contribution rates would cause the plan to sunset immediately and any additional benefits granted under MP-1 would be eliminated prospectively.

Under the 2 May 1996 version of MP-1, an increase in actuarial rates would be "added to the PUC rate to be achieved through the phased-in rate increases."⁹⁷ Mr. McGrory also prepared a power point presentation stressing that the "Employer Rate Stabilization Plan" would have "Phased Rate Increases" and that the difference between what was paid and what needed to be paid would come from the "Stabilization Reserve."⁹⁸ However, as of 7 May 1996, City labor official Cathy Lexin had yet to receive a formal written actuarial report costing the benefits that would be created under MP-1. On 7 May 1996 Ms. Lexin asked pension plan administrator Larry Grissom if the system's actuary, Rick Roeder, was "preparing something formal in writing on the costing of the benefits we've been talking about."⁹⁹

Representatives of the San Diego City Municipal Employees Association (MEA) also joined in the negotiations taking place among City officials and pension trustees over MP-1. On 14 May 1996, Ann Smith, MEA's attorney, asked Bruce Herring for the "dollar savings" to the City if the rate stabilization plan was implemented:

What is the total dollar savings for the general fund during FY97 and FY 98 if the CITY's proposed retirement system funding changes—

⁹⁵ 2 May 1996 City Employees' Retirement System Concept Overview p. 1.

⁹⁶ 2 May 1996 City Employees' Retirement System Concept Overview p. 2. See n. 95.

⁹⁷ 2 May 1996 City Employees' Retirement System Concept Overview p. 4. See n. 95.

⁹⁸ 2 May 1996 MP-1 Power Point presentation documents attached to 2 May 1996 SDCERS Board of Trustees' Minutes of Meeting.

⁹⁹ 7 May 1996 Cathy Lexin to Larry Grissom subject: "Retirement Questions."

stabilization reserve, contingency reserve, PUC to EAN funding method conversion –are adopted?¹⁰⁰

On 14 May 1996, the City Council held a closed session regarding meet and confer issues. The minutes of the closed session indicate that Mr. McGrory and Mr. Herring attended. However, as with the earlier meet and confer matters, the 14 May 1996 minutes indicate the point at which the meet and confer was brought up: “This portion of the meeting ended at 10:50 a.m. Council continued the meeting to discuss Meet and Confer matters and then adjourned to open session.”¹⁰¹ On 15 May 1996, City Manager Jack McGrory sent a memorandum to the City Council and Mayor summarizing “the major changes you authorized yesterday for the Police Officers Association, Local 145, Municipal Employees Association, and Local 127. Ratification votes are scheduled for this week.”¹⁰²

On 15 May 1996, the City’s pension board had additional discussions about the MP-1 proposal. Board member John Casey raised concerns about a new fiduciary counsel being retained to review MP-1 in place of the board’s existing fiduciary counsel, Mr. Joseph Wyatt of Morrison & Foerster:

Mr. Saathoff stated that any proposal would need approval by the Board’s actuary and fiduciary counsel.

Ms. Webster questioned whether the Administrator has the authority to move forward in retaining outside fiduciary counsel at this point.

Mr. Saathoff responded that the Board could seek a one-time legal opinion and issue an RFI for future fiduciary services.

Mr. Grissom stated that he had spoken with Dwight Hamilton regarding this issue and would be following up with him in the morning.

Mr. Casey stated that the Board had previously retained Joseph Wyatt’s firm as outside fiduciary counsel and has never voted to cancel that contract. He asked why new counsel was being sought for this issue when no discussion had taken place related to canceling the existing contract with Morrison and Foerster. He requested that this item be placed on the June agenda so that the Board could set a policy on how to retain/terminate counsel moving forward.

¹⁰⁰ On 15 May 1996, Ms. Lexin informed Ms. Smith that the estimated difference between PUC actuarial rates and agreed-to rates in the May 2 proposal for FY97 and FY98 was \$15.7million and that the general fund portion would be approximately “\$10.8 million.” 15 May 1996 letter from Ms. Lexin to Ms. Ann Smith.

¹⁰¹ 14 May 1996 San Diego City Council Closed Session Minutes p. 2.

¹⁰² 15 May 1996 Jack McGrory memorandum to Honorable Mayor and City Manager.

Mr. Saathoff ensured Mr. Casey that his request would be granted and that a policy would be put place.

During the 15 May 1996 meeting, Mr. Saathoff also indicated that the pension board was anticipating a formal proposal for its consideration by June 30, 1996. Bruce Herring reported that the "Manager's office has been meeting daily to try and reach an agreement on a formal proposal."¹⁰³ Mr. Herring stated that once agreement had been reached on MP-1, the City would be asking that the "Board act expeditiously to have their actuary and fiduciary counsel review the proposal."¹⁰⁴

A 17 May 1996 letter from MEA attorney Ann Smith to Cathy Lexin showed how deeply the 1996 meet and confer process over labor agreements with the City's employee unions had become entangled with the administration of the City's pension system. In her 17 May 1996 letter to Ms. Lexin, Ms. Smith wrote that the MEA wanted a "vast improvement" in the formula used to calculate pension benefits for the City's general member employees:

I cannot state strongly enough how committed MEA's leadership and Negotiating Team are to the following outcomes: (1) a vast improvement in the retirement formula for general members in view of the resources available to the system [which resources constitute participants' money], and in view of the richness of the present and projected benefits for safety members by comparison; and (2) parity in general salary increases for all CITY employees regardless of job classification.¹⁰⁵

Ms. Smith acknowledged that the resources available to the system that were the focus of her 17 May 1996 letter were the "participant's money" already in the pension system.¹⁰⁶ As such, the sole and exclusive responsibility over these assets (the participant's money) rested with the pension board of administration: "The retirement board of a public pension or retirement system shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system."¹⁰⁷

Because the MP-1 package proposed to make changes in the reserves and funding methods used by the pension system, the board of administration acting in their fiduciary duties, not City officials, should have determined how to use those funds. However, as

¹⁰³ 15 May 1996 SDCERS Retirement Board of Administration Minutes pp. 13-14.

¹⁰⁴ 15 May 1996 SDCERS Retirement Board of Administration Minutes pp. 13-14. See n. 103.

¹⁰⁵ 17 May 1996 Letter from Ann Smith to Cathy Lexin re: MEA's Proposal for Resolution of Retirement System Issues and Contract Extension Covering FY98.

¹⁰⁶ 17 May 1996 Letter from Ann Smith to Cathy Lexin re: MEA's Proposal for Resolution of Retirement System Issues and Contract Extension Covering FY98. See n. 105.

¹⁰⁷ Cal. Const. Art. XVI, § 17(a). See n. 1.

Mr. Casey wrote, the MP-1 call for “a benefit increase for a reduction in actuarial rates” put the board in the position of a negotiator rather than administrator of the plan assets. Ms. Smith ignored that distinction in her 17 May 1996 letter.

Moreover, Ms. Smith acknowledged how difficult it would be to get plan participants to go along with the “tampering with funding methods” proposed in MP-1. Therefore, Ms. Smith proposed a quid pro quo arrangement in which the MEA would undertake the “formidable task” of persuading plan participants to go along with MP-1 in exchange for “respectable and credible” increases in benefits for MEA members:

I also cannot over-emphasize that the level of employee skepticism and distrust regarding any tampering with funding methods related to the retirement system is enormous and will require a yeoman’s effort by every person associated with MEA to overcome. MEA will not undertake this formidable task unless the gains in benefit levels for the employees MEA represents are clearly respectable and credible rather than de minimus. Frankly, at this juncture, the proposal to increase the general member’s formula from 1.48% to 1.75% at age is de minimus when contrasted with a proposed safety formula of **3% at age 55** and **2.74% at age 50**.¹⁰⁸

Ms. Smith closed her 17 May 1996 letter by noting that she and Cathy Lexin would be meeting on Monday, 20 May 1996.¹⁰⁹ On 25 May 1996, the City’s pension system actuary, Rick Roeder, provided pension administrator Grissom with the “latest version” of the contribution cost estimates for MP-1. Mr. Roeder had determined that the general benefit formula and disability increases under MP-1 would require a contribution rate increase of 3.64% of general payroll. Mr. Roeder’s estimates of MP-1’s effect on contribution rates were as of 30 June 1995. Mr. Roeder concluded by stating that the “total increase in accrued liabilities as a result of the benefits improvements is estimated to be \$76.3 million dollars.”¹¹⁰

The City Council held another closed session regarding MP-1. Closed session materials that were recovered from Ms. Lexin’s documents include a document entitled “Closed Session Meet and Confer 28 May 1996.”¹¹¹ Among the items listed was: “1. Retirement Proposal Page No. 10-1 thru 10-4.”¹¹² The second page of this document was entitled “Proposal Overview.” One of the headings on the second page was:

¹⁰⁸ 17 May 1996 Letter from Ann Smith to Cathy Lexin re: “MEA’s Proposal for Resolution of Retirement System Issues and Contract Extension Covering FY98.” See n. 105.

¹⁰⁹ 17 May 1996 Letter from Ann Smith to Cathy Lexin re: MEA’s Proposal for Resolution of Retirement System Issues and Contract Extension Covering FY98” p. 3. See n. 105.

¹¹⁰ 25 May 1996 Letter from Rick Roeder to Larry Grissom.

¹¹¹ 28 May 1996 Closed Session Meet and Confer documents.

¹¹² 28 May 1996 Closed Session Meet and Confer documents. See n. 111.

RATE STABILIZATION PROPOSAL:

Increase Employer Rates .50%/year

Provide Benefit Improvements

Pay Difference From Excess Earnings.¹¹³

Also contained on the second page of the 28 May 1996 closed session materials was an alternative clearly demonstrating that City officials were looking for ways to balance the City's budget:

ALTERNATIVE:

Pay the Actuarial Rate

Cut \$8.66 m from FY97 Budget.¹¹⁴

Page 3 of the 28 May 1996 closed session materials described the MP-1 proposal under the heading "San Diego City Employees' Retirement System (SDCERS) P R O P O S A L."¹¹⁵ Below this heading were listed the following proposed items that clearly show that the document would have fully informed the City Council of the details of the MP-1 proposal:

I. BENEFIT CHANGES

- a. Eliminate Disability Income
- b. Pre-1980 Retirees Health Insurance (\$600/yr)
- c. Increase 13th Check from \$30/yr of service to \$60/yr for Pre-10/6/80 retirees and to \$75/yr for Pre-12/31/71 retirees
- d. Provide for purchase of up to 5 years service credit
- e. Improve General Member Formula
- f. Increase Disability Benefit Formula for General Members from 33-1/3% to 50%
- g. Improve Safety Member Formula
- h. Establish a Deferred Retirement Option Plan (no cost to City/CERS)

* * *

III. RATE STABILIZATION

- a. Pay Budgeted Employer Rates for FY96 and FY97
- b. Increase Employer Rate by .50 until Rate Reaches PUC (Projected Unit Credit) Rate/Switch to EAN (Entry Age Normal) Rates When Rates Cross
- c. Pay Difference Between Actuarial Rate and Agreed-To Rate from Undistributed Surplus Earnings

¹¹³ 28 May 1996 Closed Session Meet and Confer documents p. 2. See n. 111.

¹¹⁴ 28 May 1996 Closed Session Meet and Confer documents p. 2. See n. 111.

¹¹⁵ 28 May 1996 Closed Session Meet and Confer documents p. 3. See n. 111.

IV. RESERVES

- a. Create Contingency Reserve (1% of assets)
- b. Create Stabilization Reserve (up to \$75m from Surplus Undistributed Earnings)

V. APPROVAL PROCESS

- a. Contingent Upon All Labor Organizations Ratifying FY98 MOU Extensions and Supporting Changes with CERS and Participant Vote
- b. Contingent Upon Approval of CERS Board, Fiduciary Counsels, City Attorney & Actuary
- c. Contingent Upon Final Approval of City Council.¹¹⁶

The 28 May 1996 minutes of the City Council's closed session indicate that Mr. McGrory and Mr. Herring were present. The minutes show that after considering unrelated litigation matters "Council continued with meet and confer items until 10:00 A.M."¹¹⁷

On 29 May 1996 Ms. Cathy Lexin, the City's labor relations manager, provided the City's outside fiduciary counsel with "what we believe to be the final draft of the City Manager's Proposed Changes to the San Diego City Employee's Retirement System." Ms. Lexin noted that the major difference in the new draft dated 28 May 1996 is "the inclusion of a benefit/formula improvement for the Safety Members."¹¹⁸

On 4 June 1996, the San Diego City Council held a closed session to discuss meet and confer items. In attendance were City Manager Jack McGrory and Deputy City Manager Bruce Herring.¹¹⁹ Materials for the 4 June 1996 closed session contained meet and confer documents, including the "Retirement Proposal" and a "City Employees Retirement System June 4, 1996 Proposal."¹²⁰

By June 5, 1996, Ron Saathoff, president of San Diego City Fire Fighters Local 145, Garry Collins, president of the San Diego Police Officers Association (POA), Ed Lehman, president of AFSCME Local 127, and Judy Italiano, president of MEA, had signed off on the 4 June 1996 proposal.¹²¹ In each instance the signatures of the union

¹¹⁶ 28 May 1996 Closed Session Meet and Confer documents p. 3. See n. 111.

¹¹⁷ 28 May 1996 San Diego City Council Closed Session Minutes p. 2.

¹¹⁸ 29 May 1996 Letter from Cathy Lexin to Jeffrey Leavitt (with 28 May 1996 proposal attached) with a copy to Deputy City Attorney John Kaheny.

¹¹⁹ 4 June 1996 San Diego City Council Closed Session Minutes.

¹²⁰ 4 June 1996 Closed Session Agenda "City Employees Retirement System June 4, 1996 Proposal."

¹²¹ 4 June 1996 Management Proposal with Fire Fighters Local 145 (signed 5 June 1996), the POA, AFSCME Local 127, and the MEA for the FY98 MOU Extensions.

representatives were preceded by a provision, acknowledged and agreed to by the union presidents on behalf of their respective unions, that the “interrelationship of these various issues to each other necessitates that the entire proposal be considered and acted upon concurrently.”¹²²

On 6 June 1996, City Manager Jack McGrory informed the Mayor and City Council that an agreement had been reached on 5 June 1996, with MEA and Locals 127 and 145 on the “proposed changes to the City Employees Retirement System” contained in the 4 June 1996 proposal.¹²³

The 4 June 1996 proposal agreed to by the City and its four union presidents, which was based upon an estimated cost of \$110.35 million, provided not only that the cost would be “paid from excess earnings [and] includes \$71.31 million in contributions as a result of benefit improvements”¹²⁴ but also that employees would pay the “full cost” of the pension service credit benefits. The proposal also increased the percent of salary that general members earn each year from 1.48% to 2.0% at age 55. This was certainly the “respectable and credible rather than de minimus” increase that Ms. Smith had sought in exchange for the MEA’s support of the MP-1 proposal.

The past liability for increases in general member pension and disability payments was to “be paid for by the City through excess earnings.” The employer’s share was to be “added to the actuarial rate (PUC) calculations beginning mid-year FY97. The employee’s share was in part to be “paid from excess earnings for FY97.”¹²⁵ Again, this was an agreement simply to increase the pension deficit and push the costs of the benefits onto future generations. Regarding the DROP program, the 4 June 1996 proposal provided that it “would have no cost impact to the City or CERS” and that the City would, at the end of three years, have the right to evaluate the effect of the program and the unilateral right to prospectively terminate it.¹²⁶

The 4 June 1996 proposal was revised on 6 June 1996, and then again on 7 June 1996. Under the terms of the latter version, the City was offering seven benefit increases

¹²² 4 June 1996 Closed Session Agenda “City Employees Retirement System June 4, 1996 Proposal.” See n. 120.

¹²³ 6 June 1996 Memorandum from City Manager Jack McGrory to Mayor and City Council re: Labor Negotiations FY 98 Tentative Agreements.

¹²⁴ 4 June 1996 Closed Session Agenda “City Employees Retirement System June 4, 1996 Proposal,” p. 5. See n. 120.

¹²⁵ 4 June 1996 Closed Session Agenda “City Employees Retirement System June 4, 1996 Proposal” p. 3. See n. 120.

¹²⁶ 4 June 1996 Closed Session Agenda “City Employees Retirement System June 4, 1996 Proposal” p. 5. See n. 120.

in exchange for a reduction of the City's contribution rate to the pension fund,¹²⁷ and the City's power to rid itself of the DROP program was weakened:

At the end of three (3) years, the City will evaluate the cost impact of this program. If the cost impact to the City or CERS is greater than the savings, the City agrees to meet and confer to impasse prior to imposing any changes in the DROP plan. If the City proposes to change the DROP Plan, the 90% cap on CERS would also be re-negotiated.¹²⁸

On 11 June 1996, the City's pension board convened a "special workshop" to discuss the 7 June 1996 version of City Manager Jack McGrory's MP-1 proposal. The purpose of this meeting, which was held with the understanding that "no action" would be taken on the MP-1 proposal "until the regularly scheduled Board meeting of 21 June 1996,"¹²⁹ was to receive "1) presentation of the Manager's proposal by Mr. McGrory; 2) questions and comments from the Board; fiduciary counsel Dwight Hamilton; and actuary Rick Roeder."

During his 11 June 1996, presentation at the workshop, Mr. McGrory reminded the pension board that on 2 May 1996, he had provided a draft of MP-1.¹³⁰ Mr. McGrory indicated that representatives from his office had discussed MP-1 with the board's actuary and the City's independent fiduciary counsel.¹³¹ He then summarized the proposal:

Mr. McGrory summarized the proposal stating that it offers improved retiree cost-of-living benefits and health insurance which if adopted, would become a System liability; it recommends elimination of the disability offset; offers a wider purchase of service program at no additional cost to the City; includes a DROP plan which is similar to a deferred retirement; and would assist the City in stabilizing their contribution rates. This would be accomplished through changing the System's funding methodology by eliminating the current PUC (Projected Unit Credit) method, and phasing in the original EAN (Entry Age Normal) method over a period of time.¹³²

¹²⁷ 4 June 1996 Closed Session Agenda "City Employees Retirement System June 4, 1996 Proposal" pp. 2-6. See n. 120.

¹²⁸ 7 June 1996 City Employees Retirement System Proposal p. 5.

¹²⁹ 11 June 1996 Minutes of the SDCERS Special Workshop meeting p. 1.

¹³⁰ 11 June 1996 Minutes of the SDCERS Special Workshop meeting p. 1. See n. 129.

¹³¹ 11 June 1996 Minutes of the SDCERS Special Workshop meeting p. 2. See n. 129.

¹³² 11 June 1996 Minutes of the SDCERS Special Workshop meeting p. 2. See n. 129.

After discussing the benefits to be given in exchange for reduced City contributions to the plan, Mr. McGrory represented that the City would increase its contributions to the pension plan:

As the proposal related to the City's contribution rates, Mr. McGrory stated that it is recommended that the employer contribution rate be increased beginning in fiscal year 1998, but that the increase be phased in over time at a rate of 0.5% per year, until such time as the rates equal Entry Age Normal (EAN) as determined by the Board's actuary. At that time, it is recommended that the City convert from the PUC (Projected Unit Credit) funding to EAN. Until then, the difference between the PUC rate, as determined by the actuary, the rate of the 0.5% per year would be paid from the System's earnings stabilization rate reserve. He stated that the City had budgeted 7.08% for the current fiscal year and that the PUC rate is 8.06%-this would increase to 10.87% and up to 12.18% in the year 2007. *** This reserve would be used for two purposes: 1) to pay for all of the costs for employees who would receive the retirement formula benefit increase (approximately \$71.31 million); and, 2) to assist the City in stabilizing and increasing their contribution rates using the additional \$39 million.

He stated that currently there is approximately \$10.07 million in the earnings stabilization reserve which was created last year and an additional \$18.85 million which is 50% of the 1995 surplus, for a total of \$29.55 million. He stated that the City is proposing to transfer the \$29.55 million into the stabilization reserve, and that the actuary has estimated \$116 million in total earnings to the System in FY 96. Once the distribution to the employer/employee reserve, the retirement administration costs, the health insurance and 13th check benefit have occurred, there would be approximately \$70.7 million remaining, with \$79.3 million in surplus undistributed earnings. The City is proposing that 50% of that be transferred to the earnings stabilization reserve for an additional \$39.65 million. This would result in the creation of a System earnings stabilization reserve of \$69.2 million this year.¹³³

According to the San Diego City Attorney, in representing the MP-1 proposal to the board, Mr. McGrory was acting as a fiduciary to the board. As such, he failed in his duty to advise the board that the moneys in the pension system that he proposed to use for the stabilization reserve already belonged to the system.

At the 11 June 1996 workshop, Mr. McGrory told the pension board members that the meet and confer process had been completed.¹³⁴ In addition, Mr. McGrory stated

¹³³ 11 June 1996 Minutes of the SDCERS Special Workshop meeting p. 4. See n. 129.

¹³⁴ 11 June 1996 Minutes of the SDCERS Special Workshop meeting p. 4. See n. 129.

that “the Board’s actuary had provided the City with all of the cost information related to these proposals.”¹³⁵ The discussion then turned to how the “surplus earnings” could be used to finance the costs of the increased benefits, and the pension administrator attempted to explain how the process works:

In response to Ms. Wilkinson’s question, Mr. Grissom stated that the stabilization reserve is money held outside of the assets used for the purpose of the actuarial valuation. When this occurs, money is transferred from that fund back into System assets. While the fund is not “whole” per se, a step has been made toward keeping the liability from growing to a much higher level.

Ms. Wilkinson then asked if the numbers were arbitrary as far as the difference is concerned.

Mr. Grissom responded that once all has been paid as required by the Municipal Code, the remainder is considered to be surplus earnings. As it now stands, 100% of surplus earnings is put back into the employer contribution reserve for the sole purpose of reducing the System’s unfunded liability. What this plan visualizes is that 50% of that surplus would be put in the stabilization reserve, while the other 50% would be put into the employer’s contribution reserve. As a means to make this rebalancing possible, money would be taken from the stabilization reserve and put back into the employer contribution reserve.

Article XVI § 17 of the California Constitution is clear that public pension plan assets are to be administered by the pension board -- that is, not by City Manager Jack McGrory: “the retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system”¹³⁶ and the “sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system.”¹³⁷ Moreover, the assets of the pension fund belong to the pension fund and should not have been used to finance the City’s contribution rate reductions: “The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.”¹³⁸

¹³⁵ 11 June 1996 Minutes of the SDCERS Special Workshop meeting p. 4. See n. 129.

¹³⁶ Cal. Const. Art. XVI, § 17(a). “The power of the board of administration of a pension plan is subject to conditions discussed herein.” See n. 1.

¹³⁷ Cal. Const. Art. XVI, § 17(a). See n. 1.

¹³⁸ Cal. Const. Art. XVI, § 17(a)(b). See n. 1.

In addition, the retirement board and plan administrator were wrong when they allowed the City's budget priorities to take precedence over their duties to plan participants by their agreement to permit the City to pay less than the actuarially required funds needed by the plan:

The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.¹³⁹

During the 11 June 1996 workshop, Mr. McGrory told the board that he had "spent a significant amount of time working with members of Staff and the Retirement Board on the MP-1 proposal. Board president Enerson concurred"¹⁴⁰ and admitted that on numerous occasions he had met with the manager's office to develop a proposal that would be acceptable to all parties involved.¹⁴¹ The pension plan administrator, Lawrence Grissom, was a fiduciary to the plan and should not have been involved in using plan assets ("surplus earnings") to reduce the City's legal liability to make actuarially determined contributions to the plan.¹⁴²

Mr. Roeder verified that his firm had generated the numbers that were presented:

Mr. Roeder confirmed that the numbers that were presented were generated by his firm. He stated that if all of these benefits are put into place and are reflected in the 6/30/96 valuation, from a technical standpoint, there would be approximately \$80 million which will have the impact of a 5% reduction in whatever the funding ratio would be at that point.

Mr. Casey asked about the long-term impact of creating the contingency and stabilization reserves and how this would affect the System 10-15 years in the future.

¹³⁹ Cal. Const. Art. XVI, § 17(b). (Emphasis added.) See n. 141.

¹⁴⁰ 11 June 1996 Minutes of the SDCERS Special Workshop meeting p. 12. See n. 129.

¹⁴¹ 11 June 1996 Minutes SDCERS board of trustees Special Workshop p. 12. See n. 129.

¹⁴² San Diego Charter § 143. ("City shall contribute annually an amount substantially equal to that required of the employees for normal retirement allowances, as certified by the actuary."). See Cal. Const. Art. XVI, § 17(a); see also Employee Retirement Income Security Act (ERISA) § 404(a)(1), requiring fiduciaries to act solely in the interest of plan participants and beneficiaries. See n. 8.

Mr. Roeder responded that the impact would be relatively negligible to the extent that the amounts that are set aside would be periodically reviewed and used to fund part of the City's contributions in bad market years.

In relation to the 10% drop, Mr. Roeder stated that if the funded ratio drops 10% from the June 30, 1996 funded ratio, the proposal sunsets. Additionally, he said that there may be actuarial gains this year. Absent any benefit increases, he reported that the System may have been at a 90%-95% funding level.

Ms. Wilkinson stated that a 15% drop would lower the System's funding level to the high 70 percent range and asked what this amounts to in dollars.

Mr. Roeder responded that the 10% drop would not occur for another 5-6 years and that this would be hard to predict. However, he stated that currently, the amount at 15% would be approximately \$225 million.

Mr. Roeder responded that he would have been reluctant to recommend this plan without some sunset provisions. However, he stated that he believes that this is a sound proposal as long as the funded ratio does not drop significantly, and with the appropriate sunset¹⁴³ provisions in place.¹⁴⁴

It was at this point that Mr. Roeder's firm and clear advice could have made a critical difference in stopping the ill-fated MP-1 proposal from going forward. However, Mr. Roeder at this meeting and throughout MP-1 negotiations instead adopted the role of facilitator rather than independent adviser working for the best interests of plan participants. With his advice to the pension board in considering MP-1, Mr. Roeder's conduct fell below applicable professional standards,¹⁴⁵ for in providing guidance to the pension board on explaining the actuarial affect of MP-1 to plan participants and board members, he was acting as a plan fiduciary.

¹⁴³ In 2002 when the trigger was hit, the sunset provisions should have kicked in, and the benefits created under MP-1 should have been set aside. This result did not occur. During the 11 June 1996 workshop, Mr. Grissom stated that the sunset provision "is applicable to the entire proposal." 11 June 1996 Minutes of the SDCERS Retirement Board Special Work Shop meeting. See n. 129.

¹⁴⁴ 11 June 1996 Minutes SDCERS board of trustees Special Workshop p. 12-15. See n. 129.

¹⁴⁵ See generally June 2005 letter from the City of San Diego Audit Committee relating to Mr. Roeder; *When Is Employer, Labor Union, Affiliated Entity or Person or Pension or Welfare Plan 'Fiduciary' within meaning of §3(21)(A)(i) or (iii) or Employee Retirement Income Security Act of 1974* 178 A.L.R. Fed. 129 (2005). See n. 72.

The central reality of the MP-1 proposal was the agreement among all the parties to pass on the costs of the new benefits and intentional underfunding of the pension plan to future generations. The pension board's 11 June 1996 discussion focused on this reality:

She [Ms. Jamison] questioned whether future tax payers would be placed in a position of having to pay for these benefit increases if they are adopted, and how this curve would affect the City's obligation.¹⁴⁶

Mr. Casey stated that there is an underlying statement in the Charter that indicates that today's service credit must be paid for by today's taxpayers. He stated that this proposal gives him the distinct impression that future taxpayers will be paying for these benefit increases. He questioned if this would be the case.

Mr. Casey stated that if this proposal is implemented, he has concerns that the younger generation will be expected to pay retirement benefits for today's generation. He stated that he does not believe this is appropriate.

Mr. Roeder responded that there is no question that the rate that is being agreed upon is less than what he considers to be the 'ivory tower' actuarial rate over the next ten years. Therefore, some of these costs will be borne by the future generation. (Pension Board's 11 June 1996 Meeting)

In assessing the effect of MP-1 on the pension system, neither the pension board members, the pension administrator, nor the actuary asked the right questions or took the right actions, and because of their failure, the San Diego City pension plan faces a historic financial crisis. The pension plan has a deficit of at least \$1.7 billion dollars. Plan participants hold paper interests that are worth about 60 cents on the dollar. Pension plan fiduciaries violated their constitutional duty to prudently manage the City's pension plan:

(c) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.¹⁴⁷

¹⁴⁶ 11 June 1996 Minutes SDCERS board of trustees Special Workshop p. 15. See n. 129.

¹⁴⁷ See Cal. Const. Art. XVI, § 17(c). (Emphasis added.) See n. 1.

The pension board also heard from a privately retained legal counsel regarding the fiduciary implications of the MP-1 proposal. Mr. Wyatt from Morrison & Foerster, whom the board had previously retained to advise it on fiduciary matters, had cautioned against using pension money to fund a reserve account without an actuarial determination that the moneys so used were not needed by the fund to meet its actuarially determined funding needs.¹⁴⁸

Mr. Hamilton told the board that “there were ‘red flags’ raised in his mind by this proposal as it relates to the Board’s duty of loyalty to the integrity of the fund and addressed those individually.”¹⁴⁹ Mr. Hamilton also indicated that he was troubled by the ambiguity of MP-1’s sunset provision:

Additionally, he said that he was troubled by Issue #3. More specifically, he was troubled by the fact that the sunset provision does not spell out what would occur if the funded ratio were to fall lower than 10% and the sunset were to go into effect. He stated that this could have a drastic change or effect on the fund itself and the investment benefits. He stated that as it relates to the Board’s loyalty to the beneficiaries, he believes that it is important that the proposal spell out exactly what will occur if [it is] sun setting.¹⁵⁰

Mr. Hamilton raised additional concerns that MP-1 provisions would violate the right of the pension participants to a sound actuarial system:¹⁵¹

Another troublesome area to Mr. Hamilton was the specific agreement that there would be no changes in actuarial assumptions or methodology until fiscal year 2007. He reminded the Board that the pension beneficiaries and members have a vested right to an actuarially sound system and that the Board has a duty of loyalty to the integrity of the fund that cannot be contracted away. He stated that he believes that the Board’s right to annually and continually review their methodology and assumptions is essential. He was concerned that the agreement says that this will not change until the year 2007. Additionally, the statement that reads “...under extraordinary circumstances, the Board might be able to change those actuarial assumptions ...” troubled him because the definition of “extraordinary circumstances” is unclear. He stated that this language needs to be specific.

¹⁴⁸ See 22 August 1995 letter from Morrison & Foerster to SDCERS administrator Lawrence Grissom.

¹⁴⁹ 11 June 1996 Minutes SDCERS Board of Trustees Special Workshop p. 18. See n. 129.

¹⁵⁰ 11 June 1996 Minutes SDCERS Board of Trustees Special Workshop pp. 19-20. See n. 129.

¹⁵¹ See *Board of Administration v. Wilson*, 52 Cal. App. 4th 1109 (1997); see Addendum of Cases.

As MP-1 was revised, the underlying funding flaw became apparent. For fiscal year 1996, the City was to reduce its contribution rate from its current level of 8.6% to 7.08%. While it was reducing its contribution rate, the City would significantly increase the contribution rate needed to pay for the new benefits. After fiscal year 1997, the City would begin fixed payments, which would increase by .05% through 2006.

The pension board should have computed whether a .05% increase in the City's contribution rate starting in 1998 would be greater than the contribution rate needed to pay for the new benefits and for the growth of plan liabilities. Moreover, for the pension board to meet its duty to provide an actuarially sound system to the plan beneficiaries and for the City to ensure that its funding needs were met, an actuarial analysis should have been completed. Mr. Hamilton did not focus on the needed computation of any gap between the increased costs for the new benefits and the .05% increase in the City's contribution rate starting in 1998. However, as set forth above, he did focus on the failure of the MP-1 plan to provide for regular annual actuarial analyses of the funding needs of the City's pension plan.

Under the funding plan any difference between the system's actuarially determined funding needs and the amounts that the City paid into the system were to be paid out of a stabilization reserve. Although plan administrator Grissom stated that the stabilization reserve "would be capped at \$75 million,"¹⁵² the stabilization fund was to be funded with "surplus earnings," which were already plan assets.

The use of "surplus earnings" to fund the stabilization fund would dollar-for-dollar increase the unfunded liability -- that is, for each dollar transferred out of the system into the stabilization fund, the City would have to pay another dollar back. Thus the funding plan to pay for the new benefits was merely smoke and mirrors. This assessment was confirmed by the fact that the complicated reserves were not used to pay for any of the additional benefits. Rather, these costs were simply added to the unfunded liability of the pension plan. Moreover, actuary Roeder's cost estimates for the new benefits proved to be understated.¹⁵³

During the 11 June 1996 workshop, Mr. Hamilton was grilled about the fact that MP-1 would be transferring the costs of the new benefits to the next generation:

Ms. Parode raised concerns about Mr. Hamilton's statement that the decision to enrich benefits at the expense of the funding future of the fund would be one of a business issue and not a fiduciary issue seemed inappropriate. ***

¹⁵² 11 June 1996 Minutes SDCERS Special Workshop p. 10. See n. 129.

¹⁵³ Although the gap between the actual costs of the new benefits created by MP-1 and those estimated by actuary Roeder will have to be determined by a new independent actuary, the amount will be multiple millions of dollars.

Mr. Hamilton responded that if this is what he said, it was not what he meant. He clarified that the Board has a duty to protect the integrity of the fund. Therefore, benefits could be increased whereby the integrity of fund is not destroyed. On that the Board must rely on their actuary to ensure that the decision is actuarially sound. Additionally, he stated that just because the Board would be increasing the unfunded ratio does not necessarily mean that this would be a breach of fiduciary duty.

Ms. Parode asked if there are any standards available to fiduciaries regarding funding levels, stating that she assumes not all systems are fully funded. However, she questioned how far unfunded a system can become before becoming susceptible to a challenge on the Board's management of the fund.

Mr. Hamilton responded that it is not so much that the System is becoming unfunded, but that the liability of current employees/retirees are being transferred to future taxpayers.¹⁵⁴

Missing from this discussion was the fact that the City was not operating within its Charter § 99 expenditure control provisions and that City Manager Jack McGrory and the City Council owed a fiduciary duty to the City of San Diego and its taxpayers just as the pension board owed a duty to plan participants.

Ms. Parode did not let Mr. Hamilton off the hook; instead she pressed him to explain the nature of the pension board's duty to assess the City's financial ability to pay for the new benefits:

Ms. Parode asked whether the Board has a fiduciary duty to look at the future financial situation of the City prior to approving this.

Mr. Hamilton responded that the City is the settlor of the trust and that it is their employees' basic responsibility to fund it. He stated that in what he had heard today, he believes that there had been some unrest between the City and the Board based upon this exact issue. He stated that although the fund has earnings, the City does not understand why those monies cannot be used to alleviate their basic responsibility. He stated that these are difficult issues and that the Board must work with their actuary and fiduciary counsel to determine this. Decreasing the amount the employer would be paying to fund the trust on the basis that this will eventually come together from an actuarial standpoint does not necessarily mean that this would be a breach of fiduciary duty.

¹⁵⁴ 11 June 1996 Minutes SDCERS board of trustees Special Workshop pp. 22-23. See fn. 129.

Mr. Hamilton responded to direct questions about the previous opinion issued by Mr. Joseph Wyatt of the Morrison & Foerster firm regarding the use of plan assets to fund the stabilization reserve:

Mr. Hamilton responded that he had reviewed Mr. Wyatt's opinion. He stated that the key to the stabilization reserve is under the Claypool case, which says that the funds must be actuarially available. Because the Board has no way of knowing whether those funds would be actuarially available, he stated that he agreed with Mr. Wyatt's opinion regarding the annual funding of the stabilization reserve from the surplus.¹⁵⁵

Thus Mr. Hamilton had concluded that the funds that Mr. McGrory had indicated would be available to pay for the increased costs and reduced contributions from the City were not yet determined to be "actuarially available" -- a precondition to the intended use. Ms. Parode had uncovered the major defect in the MP-1 plan. No legal source of funds was identified to pay for either the reduced contributions or the increased benefits.

There was a flurry of activity during the 10 days following the 11 June 1996 MP-1 workshop and before the pension board was to meet on 21 June 1996, to consider the approval of MP-1. On 19 June 1996, the pension board administrator described additional revisions to MP-1 following the 11 June 1996 workshop. With regard to the reduction of the City's contribution rate, a new trigger feature was added to MP-1, requiring that, if the pension plan's funded ratio fell below 10% of its 30 June 1996 ratio of 92.3%, or in other words, if it fell below the 82.3%, the City would increase its contribution as the actuary determined was necessary.

B. The city will pay the agreed to rates shown above for FY 96 through FY 2007. In the event that the funded ratio of the System falls to a level 10% below the funded ratio calculated at the June 30, 1996, actuarial valuation in which the shortfall in funded ratio is calculated. The increase in the City paid rate will be the amount determined by the actuary necessary to restore the funded ratio to the proper level.

C. If the System's actuary makes changes in actuarial assumptions or methodology which are approved by the Board prior to July 1, 2007, any changes in the employers contribution rate will adjust the PUC rate to be achieved through extended incremental increases shown in paragraph A. above. If the phase in would require an extension past July 1, 2009, in order to achieve the full actuarial PUC rate, the City paid rate will be adjusted by the amount necessary to achieve full phase in by that date.¹⁵⁶

¹⁵⁵ 11 June 1996 Minutes SDCERS board of trustees Special Workshop p. 23. See n. 129.

¹⁵⁶ 19 June 1996 memorandum from Larry Grissom to Cathy Lexin re: San Diego City Employees' Retirement System Issue No. 3 Employer Contribution Rates.

Although these revisions created several problems, one central fact emerged: The revised MP-1 removed any possible doubt that the benefit costs were going to be passed on to the next generation of San Diegans. Any increase in the pension deficit due to the benefit increases or contribution rate reductions was going to be added to the pension short-fall, and the amortization period was to be extended indefinitely into the future. The hard questions asked by Ms. Parode and Mr. Casey forced revisions to MP-1 that led City, pension, and union officials pushing MP-1 to engage in ever more blatant fraudulent and unlawful behavior.

On 21 June 1996 SDCERS outside counsel Dwight Alan Hamilton provided Cathy Lexin with a draft of his opinion letter supporting MP-1.

An undated memorandum written before but in reference to the 21 June 1996 retirement board meeting and secured from the files of City labor negotiator Mike McGhee established that the following were “matters of fact for the record that are part of the deal”:¹⁵⁷

If the retirement deal is approved by the Retirement Board, at the June meeting, we believe the following are matters of facts for the record are part of deal:

1. Fiduciary Council [sic] will have unequivocally approved the deal as being legal.
2. The Actuary needs to be on record as to the total cost of the deal (Rick Roder’s June 13th memo is not the total cost. It doesn’t include the cost of pulling funds out of the system to bridge the short falls and the un-assumed (by the Retirement Board) benefit increases. The Actuary needs to be on the record point by point in the deal. The point by point costing by the Actuary should include the drop plan will not cost the City money, and the buy back will not cost the City money.)
3. After we have that cost signed on by the Actuary, we must also get from the Actuary the funding level drop in the system. For the record, only after the funding level has dropped from all facets of this proposal, will the 10% drop in funding level that counts toward sunseting the deal start. Not before.
4. By doing this deal the Retirement Board is agreeing to keep the rates at the attached schedule.
5. In agreeing to this deal the Retirement Board is implicitly agreeing to not arbitrarily change Actuarial’s [sic] assumptions to the

¹⁵⁷ Undated check list compiled on or after 13 June 1996, and before 21 June 1996, relating to MP-1; secured from the files of City labor negotiator Mike McGee. See n. 157.

detriment of the City. This doesn't mean they can't change Actuarial assumptions, it just means they won't do so arbitrarily to the detriment of the City. It also means that if they do, the rate changes will be phased in at the end of the agreed to schedule.

6. It would be a point of good faith on the Retirement Board's part to agree not to count any of their unilateral assumption changes toward the 10% sunset provision.
7. Fifty percent (50%) of excess earnings will go to a stabilization reserve as long as necessary to cover the costs of implementing this agreement. [A wavy line appears on the document through No. 7.]
8. **
9. **
10. The cost of the five-year buy back plan (purchase of service credit), is to be implemented at no cost to the City. ***
11. General members are eligible for the drop plan.
12. The drop plan negotiations will not cause this plan to sunset.
13. If the Retirement Board approves this deal and it is subsequently overturned after implementation, by the terms of the deal by City can reduce the benefits back to the position it was before the deal.¹⁵⁸

On 21 June 1996 SDCERS outside counsel Dwight Alan Hamilton provided Cathy Lexin with a draft of his opinion letter supporting MP-1. The final version of Mr. Hamilton's opinion, also dated 21 June 1996, was forwarded to pension administrator Lawrence Grissom. In his letter Mr. Hamilton stated in reference to the proposed rate stabilization plan that "[n]othing in this proposal changes the Board's discretion to adjust the actuarial assumptions on which the System is based as needed in order to insure the long-term funding integrity of the System."

This statement is false. The proposal limited the pension board's ability to impose an immediate increase in the City's contribution rate to meet the pension system's actuarial funding needs as is mandated by San Diego Charter § 143 and California Constitution Article XVI, § 17(a)-(c). Mr. Hamilton was aware that MP-1 restricted the

¹⁵⁸ Undated check list dated on or after 13 June 1996, and before 21 June 1996, relating to MP-1; secured from the files of City Labor negotiator Mike McGee.

board's discretion to manage the pension system in a way reflective of the actuarial needs of the pension system, not of the budget priorities of the City.

In his 21 June 1996 letter to pension board administrator Grissom, Mr. Hamilton admitted that he was aware of these limitations on the pension board to set actuarial rates under MP-1:

If the phase in would require an extension past July 1, 2009, in order to achieve the full actuarial PUC rate, the City-paid rate will be adjusted by the amount necessary to reach by July 1, 2009, the rate calculated by use of the entry age normal method.¹⁵⁹

Mr. Hamilton did not address the City's practical ability to make the rate adjustments by 1 July 2009, in order to fulfill the promise to adjust the contribution rate needed to reach EAN by 2009. Moreover, this agreement substantially extended the period during which the pension system would be underfunded. This extension violated the contractual rights of the pensioners to an actuarially sound pension system. *Board of Administration v. Wilson*, 52 Cal. App. 4th 1109 (1997) (arrear financing of pension contribution for only six months violated contractual right to actuarially sound pension system). By limiting the power of the board to impose contribution increases, the delayed implementation of full actuarial rates served the interests of the City at the expense of plan participants.

Mr. Hamilton also opined that it was "appropriate and the Board will be discharging its fiduciary responsibility to credit the employer contribution reserve" in the amount of \$106,700,000.¹⁶⁰ This allocation to the reserve was to come from both "surplus" undistributed earnings and a balance in the earnings stabilization reserve.¹⁶¹ However, Mr. Hamilton did not discuss the fact that these funds added directly to the underfunding of the pension plan. The scheme chosen was a convoluted way of admitting that the City did not have enough money and was therefore borrowing it from the pension plan. Eventually, the borrowing was dropped, and the costs of the increased benefits were simply added to the pension deficit. Again, Mr. Hamilton's statements in this regard were false and misleading to taxpayers, the San Diego media, and investors in San Diego City bonds.

On 21 June 1996 Assistant City Auditor Terri Webster sent an email to "city-mgr.CTL" (Cathy Lexin) regarding the 21 June 1996 revised version of MP-1. In her e-mail, Ms. Webster noted there was to be a 1:00 pm meeting with City Manager Jack McGrory, preceded by a meeting in which Ms. Webster briefed City Auditor Ed Ryan.

¹⁵⁹ 21 June 1996 letter from Dwight A. Hamilton to Lawrence B. Grissom.

¹⁶⁰ 21 June 1996 letter from Dwight A. Hamilton to Lawrence B. Grissom p. 3. See n. 159.

¹⁶¹ 21 June 1996 letter from Dwight A. Hamilton to Lawrence B. Grissom p. 3. See n. 159.

Ms. Webster told Ms. Lexin about the “4 main points that need to be added to the [MP-1] proposal.”

- 1) The proposal needs to state that ALL costs associated with the proposal need to be worked into the 6-30-96 valuation that will be used as the base from which the 10% decrease will be measured. (this includes costs associated with 13th check, health, etc. We know that Rick doesn’t normally calculate it that way but it needs to be done somehow to give as much breathing room from the 10% deal breaker.
- 2) City needs protection from scenario where third party actions result in killing the deal AFTER benefits have been given and cannot be taken back.

ie. No Charter amendment and therefore City has to keep health; or no DROP plan; or determination that City can not pay the lower rates. The City cannot afford to pay the higher benefits without the offset of rate relief and elimination of health expense.

- 3) The proposed needs to specify that an experience valuation will not occur until 6-30-99. This is needed to reduce the risk that the deal will die within the first five years do to funding ration (sic) dropping more than 10% below the 6-30-96 valuation.
- 4) Since the proposal was changed to eliminate the contingency and stabilization reserve the City needs to be told of the replacement to ensure that there is a minimum of 2 years coverage for health and 13th check (\$18M).¹⁶²

Ms. Webster’s memorandum makes it clear that the MP-1 proposal was directed at allowing the City to pay less than the actuarially required rate for as long as possible. This memorandum contradicts the letter in which Mr. Hamilton found no fiduciary breach, for in the letter he described the relief provided to the City in more obscure terms that simply did not comport with the realities of contribution rate relief Ms. Webster admitted to in her 21 June 2001 memo to Ms. Lexin.¹⁶³

Although some board members complained about being rushed into making a decision, on 21 June 1996 the San Diego pension board approved MP-1 by a vote of 8 to 3. The pension trustees voting in favor of MP-1 were Terri Webster, Bruce Herring, Sharon Wilkinson, Robert Scannell, Keith Enerson, Ron Saathoff, John Torres, and Conny Jamison. The three voting in opposition were Jack Katz, Ann Parode, and Paul

¹⁶² 21 June 1996 memorandum from Terri Webster to city_mgr.CTL.

¹⁶³ 21 June 1996 memorandum from Terri Webster to city_mgr.CT. See n. 162.

Barnett.¹⁶⁴ Mr. Barnett noted that that the board was being asked to allow the “[s]ystem to remain under-funded by a considerable amount and using the system’s surplus to help pay for additional benefits and assisting the employer with their contribution rates.”¹⁶⁵

Ms. Parode, who believed that board members should judge the City’s ability to make the payments that would be due by fiscal year 2008, asked attorney Hamilton if, during 2000, the board would be required to evaluate the City’s ability to make its financial commitments. Mr. Hamilton disingenuously responded that “if the City had not been involved with this particular proposal, the Board might be asking the same question.”¹⁶⁶

Three months later Mr. Hamilton had to revise the opinion that he had given in response to Ms. Parode’s assertion that the pension board needed to evaluate whether the City would be able to meet its obligations under MP-1. Contradicting the statement that he had made at the 21 June 1996 board meeting, Mr. Hamilton, in a 19 September 1996 letter, agreed with Ms. Parode:

Ms. Parode, in her comments at the 21 June 1996, public hearing on the City’s Manager’s proposal, compared the approval of employer contribution payments at a level less than that recommended by the actuary to that of a retirement system loaning money to an employer. Before a bank makes a loan, it has the duty to determine the ability of the borrower to repay it. We believe that the Board is held to the standard of professional bankers and bank investment advisors. If a pension fund is asked to approve employer contribution payments at a level less than the amounts recommended by the actuary, because of the unfunded liability created, the fiduciary must determine the ability of the employer to provide the funds to deliver benefits and related services to the participants and their beneficiaries when they become payable.

To discharge the duty of determining the ability of the City to provide the funds to deliver benefits and related services to participants and their beneficiaries, the Board should give appropriate consideration to audited financial statements of the City; determine whether the City is reasonably carrying out and performing the municipal services required of it by the City Charter; determine whether it establishes a budget each fiscal year that anticipates the expenditures for those mandated services and the revenue necessary to fund them from a reasonable level of taxation, state aid, and other funds; and determine whether the City is paying its debts as they become due and is doing so without stress.¹⁶⁷

¹⁶⁴ 21 June 2002 minutes of SDCERS Board meetings p. 16.

¹⁶⁵ 21 June 2002 minutes of SDCERS Board meetings p. 16. See n. 164.

¹⁶⁶ 21 June 2002 minutes of SDCERS Board meetings pp. 119-20. See n. 164.

¹⁶⁷ 19 September 1996 letter from Dwight A. Hamilton to Lawrence B. Grissom p. 4.

The City of San Diego was clearly not intending to pay its debts to the pension plan as they became due. This after-the-fact letter underscored the complete break down in the administration of the City's pension plan and the failure of Mr. Hamilton to meet his legal duties to the board and to participants in a timely manner. The the board conduct financial due diligence should have been given before the pension board approved MP-1 on 21 June 2002.

On 25 June 1996, the San Diego City Council held a closed session. Minutes of that meeting indicate that the meeting "halted at 9:41 a.m. Council continued with Meet and Confer Issues."¹⁶⁸ The closed session agenda indicates that the seventh item to be discussed was "Meet and Confer." A 21 June 1996 closed session memorandum from the City Attorney to the City Clerk identifies item three "Conference with Labor Negotiator, pursuant to Govt Code § 54957.6." The City's negotiators were identified as "Jack McGrory, Bruce Herring, Cathy Lexin, and Bill Lopez."¹⁶⁹

On 28 June 1996, City Manager Jack McGrory sent a memorandum entitled "Retirement Summary" to the Mayor and City Council. According to the memorandum, "Attached is a summary of the Retirement proposal that you requested last week." A hand-written note indicates that the docket coordinator distributed the memorandum on 1 July 1996, at 1:30 pm. The attachments to the memorandum were (1) June 28 Retirement Summary; (2) June Modifications Proposal; (3) June 7 Retirement Proposal; (4) CERS Fiduciary Counsel Opinion.¹⁷⁰

The 28 June 1996 retirement summary was identified as "San Diego City Employee Retirement System (SDCERS) Proposal identified and discussed above."¹⁷¹ The Mayor and Council members receiving this one-page document were informed of the "Benefit Changes," the "Rate Stabilization" program, and the "Process" followed to secure approval of MP-1.¹⁷² The document dated 21 June 1996, entitled "Modifications to Retirement System Proposal Dated June 7 1996," provided that changes were made to MP-1 "[a]s a result of issues raised by Dwight Hamilton, Fiduciary Counsel to the CERS

¹⁶⁸ 25 June 1996 San Diego City Council closed session minutes p. 2.

¹⁶⁹ 21 June 1996 Memorandum "Closed Session Agenda Items for June 25, 1996." The memorandum was signed by Deputy City Attorney John M. Kaheny.

¹⁷⁰ 28 June 1996 Memorandum from City Manager Jack McGrory to Mayor and City Council re: "Retirement with four attachments."

¹⁷¹ The Council and Mayor were provided with the 7 June 1996 MP-1 proposal at the 25 June 1996 closed session, where it was handed out to those in attendance. 7 June 1996 City Employees Retirement System Proposal, with handwritten note "Handed Out @ Closed Session 6/25/96."

¹⁷² 28 June 1996 Memorandum from City Manager Jack McGrory to Mayor and City Council attachment "San Diego City Employee Retirement System (SDCERS) Proposal." See n. 170.

Board.”¹⁷³ The final attachment to Mr. McGrory’s 28 June 1996 memorandum was Mr. Hamilton’s 21 June 1996 letter approving MP-1, which was discussed in detail above. The letter described the balloon payment that would be made if the funded ratio of the pension plan fell below 10% of the funded ratio calculated on 30 June 1996:

In the event that the funded ratio of the System falls to a level ten percent below the funded ratio calculated in the June 30, 1996, actuarial valuation, the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated by an amount, determined by the actuary, that is necessary to restore the funded ratio to the proper level.¹⁷⁴

However, Mr. Hamilton’s letter is ambiguous on the question of the proper amount. Despite being put on notice, he failed to provide any legal advice in the 21 June 1996 opinion letter that the Council or the SDCERS Board should evaluate the practical ability of the City to pay what the trigger would require.

It is interesting to recall that during the 11 June 1996 workshop discussed above, Mr. Roeder had estimated that a 15% drop would cost the City \$225 million. And when the trigger was hit in 2002, after the pension’s funded ratio dropped below 82.3% (more than 10% below the 1996 funded ratio of 92.3%), a dispute arose over the amount that the City was required to contribute to the pension plan

On 25 June 1996, the City Manager had requested that the MP-1 item, scheduled for that session, be continued “for further discussion.”¹⁷⁵ The closed session minutes for 2 July 1996 indicate that the recorder was excused from the closed session meeting.

The closed session agenda states “2. Meet and Confer.” The Closed Session memorandum signed by Deputy City Attorney John M. Kaheny indicates that the second item to be discussed was closed session and identified the City’s labor negotiators as Jack McGrory, Bruce Herring, Cathy Lexin, and Bill Lopez.¹⁷⁶ The supplemental docket “Adoption Agenda” identified item 500 for the 2 July 1996 public meeting of the City Council to be the fiscal year 1998 labor contract extensions. A consent motion was made by Council Member Valerie Stallings to adopt the resolution approving MP-1. The vote was unanimous:

¹⁷³ 28 June 1996 Memorandum from City Manager Jack McGrory to Mayor and City Council attachment, 21 June 1996 memorandum entitled “Modifications to Retirement System Proposal Dated June 7, 1996.” See n. 170.

¹⁷⁴ 21 June 1996 letter from Dwight Hamilton to SDCERS Administrator Lawrence Grissom purporting to approve MP-1 p. 3. See n. 159.

¹⁷⁵ 25 June 1996 Continued Item request form related to Item 208.

¹⁷⁶ See 25 June 1996 Closed Session minutes of the San Diego City Council. See n. 168; 2 July 1996 Closed Session Agenda, and the 27 June 1996 Closed Session memorandum regarding the Closed Session Agenda Items for July 2, 1996.

CONSENT MOTION BY STALLINGS TO ADOPT RESOLUTION (R-287582) Second by Stevens. Passed by the following vote: Mathis-yea, Wear-yea, Kehoe-yea, Stevens-yea, Warden-yea, Stallings-yea, McCarty-yea, Vargas-yea, Mayor Golding-yea.¹⁷⁷

Because MP-1 was approved by consent, the public was not provided a clear warning of the dangers that it threatened to the City's fiscal integrity. It would be eight years before any meaningful public discussion of MP-1 occurred, and that discussion was prompted by an investigation of City and pension officials, the loss of the City's credit rating, and the inability of the City, over the course of three years, to issue financial statements free of material error.

A 23 July 1996 memorandum from Cathy Lexin, the City's labor relations manager, to pension plan administrator Lawrence Grissom, entitled "City Manager's Retirement Proposal," set forth the "final Retirement Proposal as presented to the Retirement Board at its meeting of June 21, 1996." Subsequently, at its 2 July 1996 meeting, this proposal was presented to and approved by the City Council.¹⁷⁸ The 23 July 1996 memorandum from Cathy Lexin describing the final version of MP-1 reflected an additional change in the adjustments that would be made if the below-10%-of-the-1996-funded-ratio provision was triggered by the funded ratio dropping below 82.3%. According to the 23 July 1996 Lexin memo, in the event the 82.3% trigger point was reached, the following would occur:

The City will pay the agreed-to rates shown above for FY 96 through 2007. In the event that the funded ratio of the System falls to a level 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation which will include the impact of the benefit improvements included in this Proposal, the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated. The increase in the City-paid rate will be the amount determined by the actuary to restore a funded ratio no more than the level that is 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation.

The parties failed to make the agreement precise enough to determine the exact remedy that would follow should the 82.3% trigger point be reached. The failure to make the consequence of a trigger event precise underscored the real objective of MP-1 to -- increase benefit liabilities beyond available same-year revenues and make the next generation pay for those benefits from later-year funding sources. As will be explained subsequently, this feature of MP-1 grossly violated the liability limit provisions of Charter § 99.

¹⁷⁷ 2 July 1996 San Diego City Council Meeting Minutes pp. 1, 21-22.

¹⁷⁸ 23 July 1996 Memorandum from Cathy Lexin to Lawrence Grissom regarding the approval of the final version of MP-1; see fn. 2.

In a 31 July 1996 internal memorandum, the City pension plan administrator made clear that the MP-1 costs provided to the pension board and City Council were only “projections”: “We must remember that the projections of increased liability resulting from the implementation of the Proposal are only projections and that the actual numbers for any given year may be higher or lower.”¹⁷⁹

This memorandum also stated that the actuary would track liabilities to the pension system caused by MP-1:

The actuary will track the liabilities associated with the Proposal separately from other System liabilities and make recommendations as part of each annual actuarial valuation of an amount to transfer from the Reserve for Proposed Retirement Changes to the Employer year.¹⁸⁰

As was found by the City’s outside disclosure practices lawyers, the use of reserve funds to pay for the costs of MP-1 made no financial sense:

In application, however, this approach would have had no practical effect on SDCERS’ funding. Whenever surplus earnings are diverted to a reserve held outside System assets, the result is a dollar-for-dollar reduction to the Employer Contribution Reserve (which receives all amounts not allocated to other uses). Under this proposal, surplus earnings placed in the Earnings Stabilization Reserve would be bled annually into the Employer Contribution Reserve in amounts equal to the contribution shortfall. Upon the exhaustion of the Earnings Stabilization Reserve, the balance of the Employer Contribution Reserve would be essentially the same as if there had there been no intervening transfers. In no sense would this process compensate the System for the contribution shortfalls contemplated in MP1.¹⁸¹

The error in this approach lies in the mistaken idea that assigning previously unallocated surplus earnings to the Employer Contribution Reserve could effectively offset the contributions lost as a result of Manager’s Proposal 1. Much like the idea, previously considered and discarded, that the shortfall could be erased by allocating surplus earnings into an account held outside System assets, then, over time, transferring them back again, this approach accomplished nothing of practical value.¹⁸²

¹⁷⁹ 31 July 1996 memorandum from Lawrence Grissom to Business Procedures Committee p. 2.

¹⁸⁰ 31 July 1996 memorandum from Lawrence Grissom to Business Procedures Committee p. 2. See n. 179.

¹⁸¹ 16 September 2004 Report pp. 52-53. See City of San Diego Website.

¹⁸² 16 September 2004 Report pp. 53-54. See City of San Diego Website.

Running previously “unallocated” excess earnings through a special reserve account before booking them into the same “inside” account to which they otherwise would have gone directly does not affect System funding levels or employer contribution rates. It resolves itself into accounting entries that ultimately cancel out. The approach outlined in MP1 was, in fact, never followed.¹⁸³

The Earnings Stabilization Reserve – containing \$10.7 million in FY 1994 surplus earnings – was closed into the Employer Contribution Reserve at June 30, 1996, rather than being applied as described in the Manager’s proposal. According to SDCERS administrator Lawrence Grissom this was done because the Board found that it lacked authority under the Municipal Code to use the funds as proposed. The attempt to use FY 1995 and 1996 surplus earnings to provide contribution relief to the City also proved futile. In FY 1996, \$144.3 million was taken from FY 1995 and 1996 surplus earnings and placed in a “Proposed Retirement Changes Reserve,” in anticipation of the implementation of MP1.¹⁸⁴

In FY 1997, \$82.5 million of this amount was credited to a Reserve for Retirement Changes (City)” and \$4.3 million to a “Reserve for Retirement Changes (Port District).” Another \$3.5 million from the Proposed Retirement Changes Reserve was transferred to a newly created 13th Check Reserve, to provide a back-up source of payment for the benefit arising from the *Andrews* litigation. The remaining balance of approximately \$53.6 million was folded into the Employer Contribution Reserve, where it would have gone initially had it not been diverted into the Proposed Retirement Changes Reserve.¹⁸⁵

This amount appears to correspond to the portion of the Proposed Retirement Changes reserve derived from FY 1995 excess earnings. This \$87 million in the City and Port Reserves for Retirement Changes, the only funds purportedly dedicated to offset the funding shortfall created by MP1, was then left dormant, with no crediting of interest or additional allocations from earnings, and no withdrawals to “fund” the contribution shortfall in the years following the adoption of the Manager’s proposal. As mentioned, because these funds were held inside SDCERS assets, their allocation into designated accounts had minimal effect on the System’s funding ratio.¹⁸⁶

¹⁸³ 16 September 2004 Report p. 54. See City of San Diego Website.

¹⁸⁴ 16 September 2004 Report p. 54. See City of San Diego Website.

¹⁸⁵ 16 September 2004 Report p. 54. See City of San Diego Website.

¹⁸⁶ 16 September 2004 Report p. 54. See City of San Diego Website.

According to Mr. Grissom, nothing was done with these reserves because, again, SDCERS found it had no authority under the Municipal Code to dispense them for their designated purpose and, in addition, because he and others concluded that shifting funds from one inside account to another accomplished no more than moving “money from the left pocket to the right.”¹⁸⁷

On 10 October 1996, Dwight Hamilton’s 19 September 1996 opinion to the SDCERS Board was provided “to Mayor & Council only, not full distribution. Bcc: Ed Ryan Pat Frazier.”¹⁸⁸ Written at the behest of Ann Parode, this opinion indicated that the pension board had a duty “to determine the ability of the borrower” (the City) to pay the underfunding as required in MP-1. The pension board never fulfilled its duty to check into the City’s financial ability to make a balloon payment in the amount of hundreds of millions of dollars. At the 20 December 1996 SDCERS Board meeting, there was a brief discussion of the issue.¹⁸⁹

As of 18 December 1996, MP-1 was not yet fully implemented according to a memorandum from Jack McGrory to Keith Enerson relating to “Implementation Schedule for Manager’s Proposal.”¹⁹⁰ Mr. McGrory suggested that full implementation be pushed back to after the SDCERS target date of 27 January 1996.¹⁹¹ In the memorandum Mr. McGrory admitted that he was a plan fiduciary:

I am concerned that if we push to achieve implementation at too early a date, something could be overlooked. Part of the fiduciary duty to the members and beneficiaries of the System which we all share is to insure that benefits are accurately and equitably defined and properly administered.¹⁹²

According to a SDCERS Bulletin dated April 1997, the SDCERS plan participants’ final vote on MP-1 was held from Friday, 4 April 1997, through Sunday, 13 April 1997.¹⁹³ The SDCERS bulletin that was addressed to plan participants contained

¹⁸⁷ 16 September 2004 Report pp. 54-55. See City of San Diego Website.

¹⁸⁸ 10 October 1996 memorandum from Jack McGrory to Mayor and City Council regarding Legal Opinion from CERS Fiduciary Counsel.

¹⁸⁹ 20 December 1996 SDCERS Board Minutes pp. 11-12.

¹⁹⁰ 19 December 1996 Memorandum from Jack McGrory to Keith Enerson at the SDCERS Retirement Board.

¹⁹¹ 19 December 1996 memorandum from Jack McGrory to Keith Enerson at the SDCERS Retirement Board. See n. 190.

¹⁹² 19 December 1996 memorandum from Jack McGrory to Keith Enerson at the SDCERS Retirement Board. See n. 190.

¹⁹³ SDCERS Bulletin “BENEFITS ELECTION” April 1997.

false and material misrepresentations and misleading statements. The bulletin asserted that the SDCERS fiduciary counsel had approved the proposal. However, it did not disclose the fact that the fiduciary counsel had also advised the pension board to determine “the ability of the City to provide the funds” to pay the costs of MP-1. In addition, the bulletin did not disclose that the pension board had failed to determine whether the City had the practical ability to pay the balloon payment required by the 82.3% trigger provision. When the trigger was hit in 2002, those payments would exceed \$500 million dollars.¹⁹⁴

The SDCERS bulletin falsely stated that the proposal “includes a provision to assure the funding level of the system will not drop below a level the Board’s actuary deems reasonable in order to protect the financial integrity of the Retirement System.” MP-1 provided that if the funding level dropped, the City would have at least until 2009 to make good unless the level dropped more than 10% below the 1996 funding ratio of 82.3%. Again, the bulletin did not disclose that the City would not have the practical ability to make funding contributions needed to keep the system at 82.3%. (Currently, the funding level is 27.3% below the 1996 funding ratio of 92.3%.)

Further, the SDCERS bulletin did not disclose that, in possible violation of California Government Code § 1090, board members agreed to the proposal while they held interests in the contract creating collective bargaining improvements provisions. The SDCERS bulletin also did not disclose that the duty to fund the new pension benefits was created in likely violation of San Diego Charter § 99, which prohibits the debt undertaken by the City to pay the benefits, and that the quid pro quo agreement was entered into to help the City’s budget priorities and was likely an illegal and unenforceable contract.

The SDCERS bulletin falsely stated that MP-1’s five-year-purchase-of-service provision would be funded with payments from employees that would “make the system whole for such time.” A 24 February 1997 MEA PUL (Pass Up the Line) noted that the cost of the pension service credits had not been set and explained how it would be established:

The Retirement Board based on the advice of their actuary has the task of setting the employee cost of the Purchase of Service Credit (buy back) changes. The cost will be calculated by taking the percentage price the Retirement Board sets and multiplying it times your annual salary. **(For example: If the cost were 15% and you earn \$30,000.00 per year, [15% x 30,000.00] would equal \$4,500.00 for each year you wish to purchase.)**

The pension board has not taken effective action to recapture the losses caused by the underpricing of this program. The plan participants approved MP-1, and the plan was

¹⁹⁴ See San Diego City Attorney Interim Report II; see San Diego City Attorney Website.

implemented by the City Council in March 1997.¹⁹⁵ Approximately 2,900 of the 18,000 plan participants bought more than 13,000 pension year credits at a discount that cost the system more than \$100 million in underfunding.¹⁹⁶

There has been extensive speculation about why City Manager Jack McGrory, City pension plan administrator Lawrence Grissom, Mayor Susan Golding, and the City Council created MP-1. The City's motivation was clearly to find money to spend on other priorities. An 11 October 1996 letter from Mr. McGrory to John Gibson, Director of the Reports & Analysis Division of the Federal Election Commission, stated that the City of San Diego had spent \$6,473,032 on the Republican Convention.¹⁹⁷ The 28 May 1996 closed session writing stated that the alternative to adopting MP-1 would be a reduction in the 1997 fiscal year budget of \$8.66 million.¹⁹⁸

The San Diego City Charter and the California State Constitution limit municipal power to create liabilities.¹⁹⁹ The liability limit contained in San Diego City Charter § 99 is "meant to establish the 'pay-as-you-go' principle as a cardinal rule of municipal finance." *Westbrook v. Mihaly* 2 Cal. 3d 765, 776 (1970); *San Francisco Gas Co. v. Brickwedel* 62 Cal. 641 (1882). The "underlying philosophy of § 99 in its current form is to prevent City officials from mortgaging future revenues for present benefits." That objective is also reached by a similar liability limit clause in the California State Constitution.²⁰⁰ Charter liability limit clauses, like San Diego Charter § 99, mandate "that each year's income and revenue must pay each year's indebtedness and liability, and that no indebtedness or liability incurred in any one year shall be paid out of the income or revenue of any future year." *San Francisco Gas Co. v. Henery Brickwedel* 62 Cal. 641, 642 (1882).

As was pointed out by pension board members John Casey and Ann Parode, MP-1 created liabilities in years that exceeded those years' revenues. MP-1 pushed the

¹⁹⁵ MP-1 was implemented in a series of City Council meetings during March 1997.

¹⁹⁶ See San Diego City Attorney Interim Report II. See City Attorney's Website, and 2004 SDCERS Actuarial Valuation. See also n. 91.

¹⁹⁷ 11 October 1996 letter from City Manager Jack McGrory to John Gibson, Director Reports and Analysis Division, Federal Election Commission ("City of San Diego Expenditures" attachment).

¹⁹⁸ 28 May 1996 Closed Session Meet and Confer documents, p. 2. See n. 111.

¹⁹⁹ San Diego City Charter § 99. See n. 3; California State Constitution Art. XVI § 18, and n. 1. This part of the report presents a legal analysis that shows MP-1 is void. The San Diego City Attorney's Interim Report 3 analyzed other provisions of law that require MP-1 to be set aside. The analysis here also would apply to MP-2, the add-on contract created by the pension board and City Council in 2002. The legal basis for setting aside MP-1 offered in the City Attorney's Interim reports does not exhaust all options that the City has for setting aside MP-1 and MP-2.

²⁰⁰ The liability limit clause in the California State Constitution Article II § 18 discussed in the San Diego City Attorney Opinion was moved to Article XVI § 18. City Attorney City of San Diego Opinion (18 March 1968) *City Charter § 99-Continuing Contracts* p. 2.

unpaid liabilities into future years and onto the next generation.²⁰¹ Because the MP-1 contract was created in violation of the liability limits of San Diego Charter § 99, MP-1 is void. Again, under San Diego Charter § 99 each year's revenue must pay each year's indebtedness, and no indebtedness incurred in any one year may be paid out of the revenue of any future year. *Tehama County v. Sisson* 152 Cal. 167 (1907). In 1996 and 1997, the City was unable to incur the MP-1 liabilities because they had to be paid from the revenues of subsequent years. *Bradford v. City and County of San Francisco* 112 Cal. 537 (1896).

By requiring City officials to limit the City's liabilities to its same year revenues, San Diego Charter § 99 enshrines the pay-as-you-go mandate for financing City services:

The City shall not incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year unless the qualified electors of the City, voting at election to be held for that purpose, have indicated their assent as then required by the Constitution of the State of California, nor unless before or at the time of incurring such indebtedness provision shall be made for the collection of an annual tax sufficient to pay the interests on such indebtedness as it falls due.

In 1968 the voters amended San Diego Charter § 99 to bring it into conformity with a similar provision in the California State Constitution (Article XVI § 18). Former City Attorney Ed Butler explained that the intent behind the amendment was "to bring our Charter into conformity with the protections afforded by the State Constitution."²⁰² Article XVI § 18 of the California State Constitution requires a 2/3 vote of the electorate before liabilities exceeding revenue in the same year may be incurred:

No county, city, town, township, board of education, or school district, shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the voters of the public entity voting at an election to be held for that purpose ...²⁰³

Under the debt limit language in San Diego Charter § 99 and California State Constitution Article XVI § 18, the San Diego City Council may incur liabilities that exceed same year revenues only after an election. The election mode becomes the measure of the City's power to incur any liability beyond the limit fixed by Charter § 99.

²⁰¹ See Minutes of 11 June 1996 SDCERS board workshop. N. 129; 21 June 1996 minutes of 21 June 1996 SDCERS board; 20 December 1996 SDCERS board, n. 189; 31 July 1996 memorandum from pension fund administrator Lawrence Grissom. N. 179.

²⁰² Argument For Proposition A Signed by San Diego City Attorney Ed Butler. Proposition A was adopted by the voters at the 1968 Primary Election.

²⁰³ Article XVI § 18 (a) of the California State Constitution. See n. 1.

City of San Ta Cruz v. Wykes, 202 F. 357 (1913). When a City's power to make a contract is statutorily limited to a certain prescribed method and a contract is created in violation of the prescribed method, the contract is void:

[T]he contract is void because the statute prescribes the only method in which a valid contract can be made, and the adoption of the prescribed mode is a jurisdictional prerequisite to the exercise of the power to contract at all and can be exercised in no other manner so as to incur any liability on the part of municipality. Where the statute prescribes the only mode by which the power to contract shall be exercised the mode is the measure of the power. A contract made otherwise than as so prescribed is not binding or obligatory as a contract and the doctrine of implied liability has no application in such cases. *Reams v. Cooley*, 171 Cal. 150, 154 (1915).

Because of San Diego Charter § 99, the City Council was without power to incur the pension liabilities caused by MP-1:

Here, neither the officers of the corporation nor the corporation, by any of the agencies through which they act, have any power to create the obligation to pay for the work, except in the mode which is expressly prescribed in the charter; and the law never implies an obligation to do that which it forbids the party to agree to do. *Reams v. Cooley*, 171 Cal. 150, 155 (1915) (quoting from *Brady v. Mayor etc. of New York*, 16 How. Pr. 432).

The San Diego City Charter operates not as a grant of power but rather as an instrument of limitation and restriction on the exercise of power over all municipal affairs that the City is assumed to possess. Any contract made without regard to the Charter's limitations and restrictions is void and unenforceable. *Domar Electric, Ind. v. City of Los Angeles*, 9 Cal. 4th 161, 171 (1994); *Miller v. McKinnon*, 20 Cal. 2d 83, 88 (1942); *Reams v. Cooley*, 171 Cal. 150, 153-154 (1915); *Howard Jarvis Taxpayers Assn. v. City of Roseville*, 106 Cal. App. 4th 1178, 1186 (2003).

Because in adopting MP-1, the City Council incurred liabilities that exceeded revenues for that and later years, the City Council's action was *ultra vires* -- that is, beyond the scope or in excess of City Council's legal power or authority.²⁰⁴ An *ultra vires* act is one "performed without any authority to act.... [An] *ultra vires* act of a municipality is one which is beyond powers conferred upon it by law." Black's Law Dictionary 1522 (6th ed. 1990). The MP-1 contract created liabilities above same year revenues and was wholly beyond the powers of a municipality. MP-1 is therefore void. *Los Angeles Dredging Co. v. City of Long Beach*, 210 Cal. 348, 353 (1930); see also *Thomas v. City of Richmond*, 79 U.S. (12 Wall.) 349 (1870).

²⁰⁴ Webster's Third International Dictionary.

Because those contracting with a municipality are presumed to know the extent of its authority with regard to constitutional municipal debt limitation, all who act contrary to those limitations must bear the risk of a shortfall in the current year's revenues. *Law Offices of Cary S. Lapidus v. City of Waco*, 114 Cal. App. 4th 1361 (2004). All parties contracting with the City are required to ensure that liability contracts are made in compliance with the Charter:

It may sometimes seem a hardship upon a contractor that all compensation for work done, etc., should be denied him; but it should be remembered that he, no less than the officers of the corporation, when he deals in a matter expressly provided for in the charter, is bound to see to it that the charter is complied with. If he neglect this, or choose to take the hazard, he is a mere volunteer, and suffers only what he ought to have anticipated. If the statute forbids the contract which he has made, he knows it, or ought to know it, before he places his money or services at hazard. *Reams v. Cooley*, 171 Cal. 150, 157 (1915).

Those claiming benefits under MP-1 are presumed to have known that MP-1 was created in violation of Charter § 99's liability limits, and therefore they have no means of obtaining payment. *Weaver v. City and County of San Francisco*, 111 Cal. 319 (1986). The MP-1 claimants' ignorance of the law is no excuse: "A party engaging in business relationships with a municipality is presumed to know the law including the procedures necessary to enter into a binding contract." See *Miller v. McKinnon*, 20 Cal. 80, 83 (1942); *Seymour v. State*, 156 Cal. App. 3d 200, 205 (1984).

The framers of the California State Constitution placed the liability limits into the State Constitution to avoid floating indebtedness:

The system previously prevailing in some of the municipalities of the State by which liabilities and indebtedness were incurred by them far in excess of their income and revenue for the year in which the same were contracted, thus creating a floating indebtedness which had to be paid out of the income and revenue of future years, and which, in turn, necessitated the carrying forward of other indebtedness, was a fruitful source of municipal extravagance. The evil consequences of that system had been felt by the people at home and witnessed elsewhere. It was to put a stop to all of that, that the constitutional provision in question was adopted. *San Francisco Gas Co., v. Brickwedel*, 62 Cal. 641, 642 (1882).

Obviously, enforcing the Charter's liability limit would work a major change in favor of disciplining the City's fiscal practices:

Payment not only goes hand in hand with expenditure, but wasteful expenditures, instead of being concealed or mitigated by delay of payment or the creation of debts, must be immediately made known to the people, through the demands of the tax-gatherer for money. This system is

wholesome in this effect upon those who control and can squander the taxes. They are made sensible that their delinquencies will be known by being immediately felt by their constituents. It is wholesome in its effect upon the people. Their self interest is provoked to prompt scrutiny into conduct of their public agents. *State v. Medbery*, 7 Ohio St. 522, 541 (1857); *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 Wis. L. Rev. 1301, 1134.

A City can violate the constitutional municipal debt limitation by incurring even a very small debt if the City's other obligations during that year have already exhausted the City's total revenues for the year. *Law Offices of Cary S. Lapidus v. City of Wasco*, 114 Cal. App. 4th 1361 (2004). In San Diego the pension board and the City Council have created a massive liability and have passed that unpaid liability on to the next generation. Those who claim MP-1 as their defense may not be heard because they are required always to comply with the liability limit provisions of the Charter, and they did not do so. MP-1 is void. Although this finding might be considered radical, it is what the law requires:

We have neither the right nor the disposition, by judicial interpretation, to take away the wholesome restriction upon municipalities thus imposed by the Constitution. Of course, in giving effect to this radical change from the pre-existing condition of things, it will not be strange if some shall be found to suffer. But it must be remembered that all are presumed to know the law, and that whoever deals with a municipality is bound to know the extent of its powers. Those who contract with it, or furnish supplies, do so with reference to the law, and must see that limit is not exceeded. With proper care on their part and on the part of the representatives of the municipality, there is no danger of loss. *San Francisco Gas Co. v. Brickwedel*, 62 Cal. 641, 643 (1882).

CONCLUSION

The City of San Diego has suffered irreparable injury because elected and appointed officials failed to comply with the liability limit laws of the California Constitution Article XVI § 18 and the San Diego Charter § 99. The illegal liabilities that they created in the pension plan that many of them shared in must be set aside under these and other provisions of law previously identified in the City Attorney's other Interim Reports.

By _____
Michael J. Aguirre
City Attorney

Exhibit 13

CALIFORNIA CODES
GOVERNMENT CODE
SECTION 1090-1099

1090. Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. Nor shall state, county, district, judicial district, and city officers or employees be purchasers at any sale or vendors at any purchase made by them in their official capacity.

As used in this article, "district" means any agency of the state formed pursuant to general law or special act, for the local performance of governmental or proprietary functions within limited boundaries.

1090.1. No officer or employee of the State nor any Member of the Legislature shall accept any commission for the placement of insurance on behalf of the State.

1091. (a) An officer shall not be deemed to be interested in a contract entered into by a body or board of which the officer is a member within the meaning of this article if the officer has only a remote interest in the contract and if the fact of that interest is disclosed to the body or board of which the officer is a member and noted in its official records, and thereafter the body or board authorizes, approves, or ratifies the contract in good faith by a vote of its membership sufficient for the purpose without counting the vote or votes of the officer or member with the remote interest.

(b) As used in this article, "remote interest" means any of the following:

(1) That of an officer or employee of a nonprofit entity exempt from taxation pursuant to Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. Sec. 501(c)(3)) or a nonprofit corporation, except as provided in paragraph (8) of subdivision (a) of Section 1091.5.

(2) That of an employee or agent of the contracting party, if the contracting party has 10 or more other employees and if the officer was an employee or agent of that contracting party for at least three years prior to the officer initially accepting his or her office and the officer owns less than 3 percent of the shares of stock of the contracting party; and the employee or agent is not an officer or director of the contracting party and did not directly participate in formulating the bid of the contracting party.

For purposes of this paragraph, time of employment with the contracting party by the officer shall be counted in computing the three-year period specified in this paragraph even though the contracting party has been converted from one form of business organization to a different form of business organization within three years of the initial taking of office by the officer. Time of employment in that case shall be counted only if, after the transfer or change in organization, the real or ultimate ownership of the contracting party is the same or substantially similar to that which

existed before the transfer or change in organization. For purposes of this paragraph, stockholders, bondholders, partners, or other persons holding an interest in the contracting party are regarded as having the "real or ultimate ownership" of the contracting party.

(3) That of an employee or agent of the contracting party, if all of the following conditions are met:

(A) The agency of which the person is an officer is a local public agency located in a county with a population of less than 4,000,000.

(B) The contract is competitively bid and is not for personal services.

(C) The employee or agent is not in a primary management capacity with the contracting party, is not an officer or director of the contracting party, and holds no ownership interest in the contracting party.

(D) The contracting party has 10 or more other employees.

(E) The employee or agent did not directly participate in formulating the bid of the contracting party.

(F) The contracting party is the lowest responsible bidder.

(4) That of a parent in the earnings of his or her minor child for personal services.

(5) That of a landlord or tenant of the contracting party.

(6) That of an attorney of the contracting party or that of an owner, officer, employee, or agent of a firm that renders, or has rendered, service to the contracting party in the capacity of stockbroker, insurance agent, insurance broker, real estate agent, or real estate broker, if these individuals have not received and will not receive remuneration, consideration, or a commission as a result of the contract and if these individuals have an ownership interest of 10 percent or more in the law practice or firm, stock brokerage firm, insurance firm, or real estate firm.

(7) That of a member of a nonprofit corporation formed under the Food and Agricultural Code or a nonprofit corporation formed under the Corporations Code for the sole purpose of engaging in the merchandising of agricultural products or the supplying of water.

(8) That of a supplier of goods or services when those goods or services have been supplied to the contracting party by the officer for at least five years prior to his or her election or appointment to office.

(9) That of a person subject to the provisions of Section 1090 in any contract or agreement entered into pursuant to the provisions of the California Land Conservation Act of 1965.

(10) Except as provided in subdivision (b) of Section 1091.5, that of a director of or a person having an ownership interest of 10 percent or more in a bank, bank holding company, or savings and loan association with which a party to the contract has a relationship of borrower or depositor, debtor or creditor.

(11) That of an engineer, geologist, or architect employed by a consulting engineering or architectural firm. This paragraph applies only to an employee of a consulting firm who does not serve in a primary management capacity, and does not apply to an officer or director of a consulting firm.

(12) That of an elected officer otherwise subject to Section 1090, in any housing assistance payment contract entered into pursuant to Section 8 of the United States Housing Act of 1937 (42 U.S.C. Sec. 1437f) as amended, provided that the housing assistance payment contract was in existence before Section 1090 became applicable to the officer and will be renewed or extended only as to the existing tenant, or, in a jurisdiction in which the rental vacancy rate is less than 5 percent, as to new tenants in a unit previously under a

Section 8 contract. This section applies to any person who became a public official on or after November 1, 1986.

(13) That of a person receiving salary, per diem, or reimbursement for expenses from a **government** entity.

(14) That of a person owning less than 3 percent of the shares of a contracting party that is a for-profit corporation, provided that the ownership of the shares derived from the person's employment with that corporation.

(c) This section is not applicable to any officer interested in a contract who influences or attempts to influence another member of the body or board of which he or she is a member to enter into the contract.

(d) The willful failure of an officer to disclose the fact of his or her interest in a contract pursuant to this section is punishable as provided in Section 1097. That violation does not void the contract unless the contracting party had knowledge of the fact of the remote interest of the officer at the time the contract was executed.

1091.1. The prohibition against an interest in contracts provided by this article or any other provision of law shall not be deemed to prohibit any public officer or member of any public board or commission from subdividing lands owned by him or in which he has an interest and which subdivision of lands is effected under the provisions of Division 2 (commencing with Section 66410) of Title 7 of the **Government Code** or any local ordinance concerning subdivisions; provided, that (a) said officer or member of such board or commission shall first fully disclose the nature of his interest in any such lands to the legislative body having jurisdiction over the subdivision thereof, and (b) said officer or member of such board or commission shall not cast his vote upon any matter or contract concerning said subdivision in any manner whatever.

1091.2. Section **1090** shall not apply to any contract or grant made by local workforce investment boards created pursuant to the federal Workforce Investment Act of 1998 except where both of the following conditions are met:

(a) The contract or grant directly relates to services to be provided by any member of a local workforce investment board or the entity the member represents or financially benefits the member or the entity he or she represents.

(b) The member fails to recuse himself or herself from making, participating in making, or in any way attempting to use his or her official position to influence a decision on the grant or grants.

1091.3. Section **1090** shall not apply to any contract or grant made by a county children and families commission created pursuant to the California Children and Families Act of 1998 (Division 108 (commencing with Section 130100) of the Health and Safety **Code**), except where both of the following conditions are met:

(a) The contract or grant directly relates to services to be provided by any member of a county children and families commission or the entity the member represents or financially benefits the member or the entity he or she represents.

(b) The member fails to recuse himself or herself from making, participating in making, or in any way attempting to use his or her official position to influence a decision on the grant or grants.

1091.4. (a) As used in Section 1091, "remote interest" also includes a person who has a financial interest in a contract, if all of the following conditions are met:

(1) The agency of which the person is a board member is a special district serving a population of less than 5,000 that is a landowner voter district, as defined in Section 56050, that does not distribute water for any domestic use.

(2) The contract is for either of the following:

(A) The maintenance or repair of the district's property or facilities provided that the need for maintenance or repair services has been widely advertised. The contract will result in materially less expense to the district than the expense that would have resulted under reasonably available alternatives and review of those alternatives is documented in records available for public inspection.

(B) The acquisition of property that the governing board of the district has determined is necessary for the district to carry out its functions at a price not exceeding the value of the property, as determined in a record available for public inspection by an appraiser who is a member of a recognized organization of appraisers.

(3) The person did not participate in the formulation of the contract on behalf of the district.

(4) At a public meeting, the governing body of the district, after review of written documentation, determines that the property acquisition or maintenance and repair services cannot otherwise be obtained at a reasonable price and that the contract is in the best interests of the district, and adopts a resolution stating why the contract is necessary and in the best interests of the district.

(b) If a party to any proceeding challenges any fact or matter required by paragraph (2), (3), or (4) of subdivision (a) to qualify as a remote interest under subdivision (a), the district shall bear the burden of proving this fact or matter.

1091.5. (a) An officer or employee shall not be deemed to be interested in a contract if his or her interest is any of the following:

(1) The ownership of less than 3 percent of the shares of a corporation for profit, provided that the total annual income to him or her from dividends, including the value of stock dividends, from the corporation does not exceed 5 percent of his or her total annual income, and any other payments made to him or her by the corporation do not exceed 5 percent of his or her total annual income.

(2) That of an officer in being reimbursed for his or her actual and necessary expenses incurred in the performance of official duties.

(3) That of a recipient of public services generally provided by the public body or board of which he or she is a member, on the same terms and conditions as if he or she were not a member of the body or board.

(4) That of a landlord or tenant of the contracting party if the contracting party is the federal **government** or any federal department

or agency, this state or an adjoining state, any department or agency of this state or an adjoining state, any county or city of this state or an adjoining state, or any public corporation or special, judicial, or other public district of this state or an adjoining state unless the subject matter of the contract is the property in which the officer or employee has the interest as landlord or tenant in which event his or her interest shall be deemed a remote interest within the meaning of, and subject to, the provisions of Section 1091.

(5) That of a tenant in a public housing authority created pursuant to Part 2 (commencing with Section 34200) of Division 24 of the Health and Safety **Code** in which he or she serves as a member of the board of commissioners of the authority or of a community development commission created pursuant to Part 1.7 (commencing with Section 34100) of Division 24 of the Health and Safety **Code**.

(6) That of a spouse of an officer or employee of a public agency in his or her spouse's employment or officeholding if his or her spouse's employment or officeholding has existed for at least one year prior to his or her election or appointment.

(7) That of a nonsalaried member of a nonprofit corporation, provided that this interest is disclosed to the body or board at the time of the first consideration of the contract, and provided further that this interest is noted in its official records.

(8) That of a noncompensated officer of a nonprofit, tax-exempt corporation, which, as one of its primary purposes, supports the functions of the body or board or to which the body or board has a legal obligation to give particular consideration, and provided further that this interest is noted in its official records.

For purposes of this paragraph, an officer is "noncompensated" even though he or she receives reimbursement from the nonprofit, tax-exempt corporation for necessary travel and other actual expenses incurred in performing the duties of his or her office.

(9) That of a person receiving salary, per diem, or reimbursement for expenses from a **government** entity, unless the contract directly involves the department of the **government** entity that employs the officer or employee, provided that the interest is disclosed to the body or board at the time of consideration of the contract, and provided further that the interest is noted in its official record.

(10) That of an attorney of the contracting party or that of an owner, officer, employee, or agent of a firm which renders, or has rendered, service to the contracting party in the capacity of stockbroker, insurance agent, insurance broker, real estate agent, or real estate broker, if these individuals have not received and will not receive remuneration, consideration, or a commission as a result of the contract and if these individuals have an ownership interest of less than 10 percent in the law practice or firm, stock brokerage firm, insurance firm, or real estate firm.

(11) Except as provided in subdivision (b), that of an officer or employee of, or a person having less than a 10-percent ownership interest in, a bank, bank holding company, or savings and loan association with which a party to the contract has a relationship of borrower, depositor, debtor, or creditor.

(12) That of (A) a bona fide nonprofit, tax-exempt corporation having among its primary purposes the conservation, preservation, or restoration of park and natural lands or historical resources for public benefit, which corporation enters into an agreement with a public agency to provide services related to park and natural lands or historical resources and which services are found by the public agency, prior to entering into the agreement or as part of the agreement, to be necessary to the public interest to plan for,

acquire, protect, conserve, improve, or restore park and natural lands or historical resources for public purposes and (B) any officer, director, or employee acting pursuant to the agreement on behalf of the nonprofit corporation. For purposes of this paragraph, "agreement" includes contracts and grants, and "park," "natural lands," and "historical resources" shall have the meanings set forth in subdivisions (d), (g), and (i) of Section 5902 of the Public Resources Code. Services to be provided to the public agency may include those studies and related services, acquisitions of property and property interests, and any activities related to those studies and acquisitions necessary for the conservation, preservation, improvement, or restoration of park and natural lands or historical resources.

(13) That of an officer, employee, or member of the Board of Directors of the California Housing Finance Agency with respect to a loan product or programs if the officer, employee, or member participated in the planning, discussions, development, or approval of the loan product or program and both of the following two conditions exist:

(A) The loan product or program is or may be originated by any lender approved by the agency.

(B) The loan product or program is generally available to qualifying borrowers on terms and conditions that are substantially the same for all qualifying borrowers at the time the loan is made.

(b) An officer or employee shall not be deemed to be interested in a contract made pursuant to competitive bidding under a procedure established by law if his or her sole interest is that of an officer, director, or employee of a bank or savings and loan association with which a party to the contract has the relationship of borrower or depositor, debtor or creditor.

1091.6. An officer who is also a member of the governing body of an organization that has an interest in, or to which the public agency may transfer an interest in, property that the public agency may acquire by eminent domain shall not vote on any matter affecting that organization.

1092. Every contract made in violation of any of the provisions of Section 1090 may be avoided at the instance of any party except the officer interested therein. No such contract may be avoided because of the interest of an officer therein unless such contract is made in the official capacity of such officer, or by a board or body of which he is a member.

1092.5. Notwithstanding Section 1092, no lease or purchase of, or encumbrance on, real property may be avoided, under the terms of Section 1092, in derogation of the interest of a good faith lessee, purchaser, or encumbrancer where the lessee, purchaser, or encumbrancer paid value and acquired the interest without actual knowledge of a violation of any of the provisions of Section 1090.

1093. The State Treasurer and Controller, county and city officers, and their deputies and clerks shall not purchase or sell, or in any manner receive for their own or any other person's use or benefit any

State, county or city warrants, scrip, orders, demands, claims, or other evidences of indebtedness against the State, or any county or city thereof. This section does not apply to evidences of indebtedness issued to or held by such an officer, deputy or clerk for services rendered by them, nor to evidences of the funded indebtedness of the State, county, or city.

1094. Every officer whose duty it is to audit and allow the accounts of other state, county, or city officers shall, before allowing such accounts, require each of such officers to make and file with him an affidavit or certificate under penalty of perjury that he has not violated any of the provisions of this article, and any individual who wilfully makes and subscribes such certificate to an account which he knows to be false as to any material matter shall be guilty of a felony and upon conviction thereof shall be subject to the penalties prescribed for perjury by the Penal **Code** of this State.

1095. Officers charged with the disbursement of public moneys shall not pay any warrant or other evidence of indebtedness against the State, county, or city when it has been purchased, sold, received, or transferred contrary to any of the provisions of this article.

1096. Upon the officer charged with the disbursement of public moneys being informed by affidavit that any officer, whose account is about to be settled, audited, or paid by him, has violated any of the provisions of this article, the disbursing officer shall suspend such settlement or payment, and cause the district attorney to prosecute the officer for such violation. If judgment is rendered for the defendant upon such prosecution, the disbursing officer may proceed to settle, audit, or pay the account as if no affidavit had been filed.

1097. Every officer or person prohibited by the laws of this state from making or being interested in contracts, or from becoming a vendor or purchaser at sales, or from purchasing script, or other evidences of indebtedness, including any member of the governing board of a school district, who willfully violates any of the provisions of such laws, is punishable by a fine of not more than one thousand dollars (\$1,000), or by imprisonment in the state prison, and is forever disqualified from holding any office in this state.

1098. (a) Any current public officer or employee who willfully and knowingly discloses for pecuniary gain, to any other person, confidential information acquired by him or her in the course of his or her official duties, or uses any such information for the purpose of pecuniary gain, is guilty of a misdemeanor.

(b) As used in this section:

(1) "Confidential information" means information to which all of the following apply:

(A) At the time of the use or disclosure of the information, the information is not a public record subject to disclosure under the

Public Records Act.

(B) At the time of the use or disclosure of the information, the disclosure is prohibited by (i) a statute, regulation, or rule which applies to the agency in which the officer or employee serves; (ii) the statement of incompatible activities adopted pursuant to Section 19990 by the agency in which the officer or employee serves; or (iii) a provision in a document similar to a statement of incompatible activities if the agency in which the officer or employee serves is a local agency.

(C) The use or disclosure of the information will have, or could reasonably be expected to have, a material financial effect on any investment or interest in real property which the officer or employee, or any person who provides pecuniary gain to the officer or employee in return for the information, has at the time of the use or disclosure of the information or acquires within 90 days following the use or disclosure of the information.

(2) For purposes of paragraph (1):

(A) "Interest in real property" has the definition prescribed by Section 82033.

(B) "Investment" has the definition prescribed by Section 82034.

(C) "Material financial effect" has the definition prescribed by Sections 18702 and 18702.2 of Title 2 of the California Administrative Code, as those sections read on September 1, 1987.

(3) "Pecuniary gain" does not include salary or other similar compensation from the officer's or the employee's agency.

(c) This section shall not apply to any disclosure made to any law enforcement agency, nor to any disclosure made pursuant to Sections 10542 and 10543.

(d) This section is not intended to supersede, amend, or add to subdivision (b) of Section 8920 regarding prohibited conduct of Members of the Legislature.

1099. (a) A public officer, including, but not limited to, an appointed or elected member of a governmental board, commission, committee, or other body, shall not simultaneously hold two public offices that are incompatible. Offices are incompatible when any of the following circumstances are present, unless simultaneous holding of the particular offices is compelled or expressly authorized by law:

(1) Either of the offices may audit, overrule, remove members of, dismiss employees of, or exercise supervisory powers over the other office or body.

(2) Based on the powers and jurisdiction of the offices, there is a possibility of a significant clash of duties or loyalties between the offices.

(3) Public policy considerations make it improper for one person to hold both offices.

(b) When two public offices are incompatible, a public officer shall be deemed to have forfeited the first office upon acceding to the second. This provision is enforceable pursuant to Section 803 of the Code of Civil Procedure.

(c) This section does not apply to a position of employment, including a civil service position.

(d) This section shall not apply to a governmental body that has only advisory powers.

(e) For purposes of paragraph (1) of subdivision (a), a member of a multimember body holds an office that may audit, overrule, remove members of, dismiss employees of, or exercise supervisory powers over

another office when the body has any of these powers over the other office or over a multimember body that includes that other office.

(f) This section codifies the common law rule prohibiting an individual from holding incompatible public offices.

Exhibit 14

Section 92: Borrowing Money on Short Term Notes

Bonds or notes may be issued in anticipation of the collection of special assessments, and bonds, notes, or registered warrants on the treasury may be issued in anticipation of the collection of taxes and revenues, as authorized by the City Council by resolution and shall not be deemed the creation of debt within the meaning of Section 90 of this Article. Bonds, notes or registered warrants on the treasury issued in anticipation of the collection of the taxes of any fiscal year may be issued during each fiscal year and each such bond, note, or warrant shall specify that it is payable out of the taxes and revenues of the fiscal year in which issued, and shall not bear a higher rate of interest than the maximum rate established by Council Resolution within the legal limit, and the total amount of such bonds, notes or warrants, authorized and issued in any fiscal year shall not, in the aggregate, be more than twenty-five (25) percent of the total appropriations of the City for such year. Nothing herein contained shall be construed to authorize the incurring of an obligation against the municipality in excess of that authorized to be incurred by the Constitution of the State of California.

(Editor's note: Supplement No. 655)

(Amendment voted 11-06-1962; effective 01-21-1963.)

(Amendment voted 09-21-1965; effective 02-10-1966.)

(Amendment voted 06-03-1980; effective 07-16-1980.)

(Amendment voted 11-06-1990; effective 02-19-1991.)

Section 93: Loans and Advances

The City Council may from time to time authorize the advance of moneys in the treasury as a temporary loan to any tax-supported fund, which loan shall be repaid from the first property taxes received thereafter; provided, however, that such temporary loans shall not exceed the current property taxes receivable. It shall be lawful from time to time to advance money in the General Fund to any bond fund or to use any money in the General Fund for any purpose for which a loan shall have been authorized and bonds actually voted but not yet issued and sold, and the City officials need not sell said bonds until it is necessary to repay the General Fund advances or to replenish such loan fund or funds. The credit of the City shall not be given or loaned to or in aid of any individual, association or corporation; except that suitable provision may be made for the aid and support of the poor.

(Amendment voted 11-06-1962; effective 01-21-1963.)

Section 94: Contracts

In the construction, reconstruction or repair of public buildings, streets, utilities and other public works, when the expenditure therefor shall exceed the sum established by ordinance of the City Council, the same shall be done by written contract, except as otherwise provided in this Charter, and the Council, on the recommendation of the

Manager or the head of the Department in charge if not under the Manager's jurisdiction, shall let the same to the lowest responsible and reliable bidder, not less than ten days after advertising for one day in the official newspaper of the City for sealed proposals for the work contemplated. If the cost of said public contract work is of a lesser amount than the figure established by ordinance of the City Council, the Manager may let said contract without advertising for bids, but not until the Purchasing Agent of the City shall have secured competitive prices from contractors interested, which shall be taken under consideration before said contract is let. The Council may, however, establish by ordinance an amount below which the Manager may order the performance of any construction, reconstruction or repair work by appropriate City forces without approval by Council. When such Council approval is required, the Manager's recommendation shall indicate justification for the use of City forces and shall indicate whether the work can be done by City forces more economically than if let by contract.

In case of a great public calamity, such as extraordinary fire, flood, storm, epidemic or other disaster the Council may, by resolution passed by a vote of two-thirds of the members elected to the Council, determine and declare that the public interest or necessity demands the immediate expenditure of public money to safeguard life, health or property, and thereupon they may proceed, without advertising for bids or receiving the same, to expend, or enter into a contract involving the expenditure of any sum required in such emergency, on hand in the City treasury and available for such purpose. All contracts before execution shall be approved as to form and legality by the City Attorney.

Each bidder shall furnish with his bid such security or deposit insuring the execution of the contract by him as shall be specified by the Council or as provided by general law.

For contracts exceeding \$100,000.00, the Council shall require each contractor to insure the faithful performance of his contract by delivering to the City a surety bond in an amount specified by the Council, executed by a surety company authorized to do business in the State of California; provided, however, that in all contracts the Council shall require the retention of sufficient payments, under the contract to insure the protection of the City against labor or material liens.

The Council, on the recommendation of the Manager, or the Head of the Department not under the jurisdiction of the Manager, may reject any and all bids and readvertise for bids. The Council may provide that no contract shall be awarded to any person, firm or corporation if prison or alien labor is to be employed in performing such contract, or if the wage schedule for employees engaged in performing such contract is based on more than eight hours of labor per day. Any contract may be let for a gross price or on a unit basis and may provide for liquidated damages to the City for every day the contract is uncompleted beyond a specified date. It shall be competent in awarding any contract to compare bids on the basis of time completion, provided that when any award has been made in consideration, in whole or in part, of the relative time estimates of bidders for the

completion of the work, the performance in accordance with such time limits shall be secured by a surety bond as hereinabove provided with adequate sureties and penalties, and provided further, that for any contract awarded solely or partially on a specified time for completion the Council shall not extend such time limits unless such extension be recommended by the Manager and the Head of the Department concerned.

No officer, whether elected or appointed, of The City of San Diego shall be or become directly or indirectly interested in, or in the performance of, any contract with or for The City of San Diego, or in the purchase or lease of any property, real or personal, belonging to or taken by said City or which shall be sold for taxes or assessments or by virtue of legal process or suit of said City. Any person willfully violating this section of the Charter shall be guilty of a misdemeanor and shall immediately forfeit his office and be thereafter forever barred and disqualified from holding any elective or appointive office in the service of the City. No officer, whether elected or appointed, shall be construed to have an interest within the meaning of this section unless the contract, purchase, lease, or sale shall be with or for the benefit of the office, board, department, bureau or division with which said officer is directly connected in the performance of his duties and in which he or the office, board, department, bureau or division he represents exercises legislative, administrative or quasi-judicial authority in the letting of or performance under said contract, purchase, lease or sale.

All contracts entered into in violation of this Section shall be void and shall not be enforceable against said City; provided, however, that officers of this municipality may own stock in public utility service corporations and the City permitted to contract for public utility service when the rates for such service are fixed by law or by virtue of the Public Utilities Commission of the State of California; and provided further, that no officer shall be prohibited from purchasing the services of any utility whether publicly or privately owned, whether or not the rates are fixed by law or by the Public Utilities Commission of the State of California; and provided further, that in designating any bank as a depository for the funds of said City, any officer interested as a stockholder or otherwise in such bank shall not be deemed to have an interest in such City contract within the meaning of this section, and in each of the cases enumerated herein such contracts shall be valid and enforceable obligations against the municipality.

(Amendment voted 03-13-1945; effective 04-09-1945.)

(Amendment voted 03-11-1947; effective 03-24-1947.)

(Amendment voted 03-10-1953; effective 04-20-1953.)

(Amendment voted 09-17-1963; effective 02-11-1964.)

(Amendment voted 11-04-1975; effective 12-01-1975.)

(Amendment voted 11-02-1976; effective 01-12-1977.)

(Amendment voted 09-20-1977; effective 11-18-1977.)

(Amendment voted 11-03-1998; effective 12-04-1998.)

Exhibit 15

INTERIM REPORT NO. 12

REPORT ON SCHEME TO PRICE

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

PENSION SERVICE CREDITS BELOW COST

IN VIOLATION OF CALIFORNIA LAW

REPORT OF THE

SAN DIEGO CITY ATTORNEY

MICHAEL J. AGUIRRE

OFFICE OF
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CITY OF SAN DIEGO

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18 SEPTEMBER 2006

I.

INTRODUCTION

The San Diego City Attorney is issuing Interim Report No. 12 to provide evidence supporting the assertion that certain employee benefit programs approved by the San Diego City Council and administered by the San Diego City Employees' Retirement System were created and administered illegally. Evidence provided in this report illustrates that the City's Purchase of Service Credit program was created illegally, the cost of the benefit was priced illegally, and that the benefit should be rescinded.

This report is issued as part of the City Attorney's plan for financial recovery, comprised of the following critical steps to restore the financial health of the City: void the illegally created retirement benefits, reset the parameters of the pension system to bring assets and liabilities into balance, and find new revenue sources to pay for legal retirement benefits. The current unfunded liability of the pension system is estimated at more than \$1.4 billion. This looming debt is the greatest financial threat facing the City of San Diego.

Evidence presented in Interim Report No. 12 will show that through the creation of the purchase of service program:

1. The City Council illegally authorized the Board of Administrators at the San Diego City Employees' Retirement System to grant pension benefits.
2. The San Diego City Employees' Retirement System violated their fiduciary duties to the pension system by knowingly and willingly pricing the years of service credits below their cost to the City, thereby placing the financial security of the system in jeopardy.

The City Attorney believes that the 5-year Purchase of Service Program (PSC) created as part of Manager's Proposal I ("MP I") in 1996 should be closed and the money paid into the program should be returned to the participating employees, with interest.

II.

THE CREATION OF THE 5-YEAR PURCHASE OF SERVICE CREDIT PROGRAM

Like many retirement benefits administered by the San Diego City Employees' Retirement System, the purchase of service credit benefit program created in 1996 has become an unsustainable burden and threatens the financial integrity of the retirement system.

The five year PSC program was created as part of MP I between the City and the San Diego City Employees' Retirement System (SDCERS) Board. The agreement was a

quid pro quo deal whereby the City agreed to increase pension benefits in exchange for the SDCERS Board of Administrators allowing the City to underfund the retirement system.

In the first known correspondence memorializing discussions about employee benefit increases in exchange for granting the City relief in its contributions to the pension system, there was no mention of a modification to the purchase of retirement service program. A memo from then City Manager Jack McGrory on Thursday, 29 February 1996, outlines a discussion which set the stage for the MPI deal.¹ In the memo, McGrory described his conversation with Lawrence Grissom, administrator of the San Diego City Employees' Retirement System (SDCERS), and Keith Enerson, president of the SDCERS Board of Administrators.

The response from Grissom proposed a new benefit that would allow more employees to purchase years of service in the City's pension system in lieu of actual work performed for the City. In short, this meant that if an employee worked for 15 years, the employee would be given the opportunity to buy five additional years of service which would allow an employee to retire with 20 years of service in their retirement package. This new feature would boost the employee's annual pension payments by thousands of dollars. In a memo to Enerson on 1 March 1996, Grissom² proposed:

Change purchase of service. My recommendation follows:

- a. Keep refunds, probationary period, 1981 plan waiting period, and Military & Veteran Code required military service intact.
- b. Eliminate all other existing categories of purchase.
- c. Replace with a program allowing any member to purchase up to 5 (3?) years of additional service at any time or at retirement. Purchase cost to be calculated based on individual contribution rate including offset, City contribution rate, and current salary. Purchase at time of retirement can be made using some form of negotiated credits for unused annual leave.³

¹ 29 February 1996. E-mail from Jack McGrory to "Distribution." Subject: "Retirement" (Exhibit 1)

² 1 March 1996. E-mail from Larry Grissom to Keith Enerson. Subject: Proposed Retirement Package. (Exhibit 2)

³ 1 March 1996. E-mail from Larry Grissom to Keith Enerson. Subject: Proposed Retirement Package. (Exhibit 2)

Grissom said this would be a profitable deal for employees, "This is a potentially great benefit." He, however, immediately identified potential problems with enacting such an expansion in the number of employees allowed to purchase years of service. Specifically, he foresaw potential problems in how the years would be priced by the System and purchased by employees. Grissom expressed his concerns:

There are, however, some problems. The amount a member is allowed to pay for purchase is governed by Section 415.⁴ Paying for purchase with annual leave credits is a possible way around this, but this raises issues with the taxability of the annual leave credits and possible discrimination issues (males tends to have significantly higher leave balances than females). Safety members are likely to scream at the cost calculation basis because their contributions rates are so much higher than general members (150% employee and 300%). There are always solutions. I have talked with Bob Blum and Rick [Roeder] and we are working on a variety of ideas.⁵

The memo was written as the City was entering the meet-and-confer period with municipal labor unions including the Municipal Employees Association, the San Diego Firefighters Association Local 145, the American Federation of State, County and Municipal Employees Local 127, and the Police Officers Association. These negotiations focused on upcoming labor contracts that typically memorialize issues for City employees that include retirement benefits, vacation time, salary increases, etc. It was during these negotiations that the benefit would take form.

The City's negotiating team met with labor unions for the meet-and-confer on 5 March 1996⁶ and 19 March 1996.⁷ Both agendas list "Conference with Labor Negotiator" and included representatives of the City and representatives of the City's municipal labor unions.

At this point, there had been little discussion as to how the PSC program would be priced and how much they would cost the employees. More importantly, there was no mention of how the years would affect the financial health of the system.

⁴ Section 415 of the Internal Revenue Code governs pension plans.

⁵ 1 March 1996. E-mail from Larry Grissom to Keith Enerson. Subject: Proposed Retirement Package. (Exhibit 2)

⁶ Agenda for the San Diego City Council closed session agenda of 5 March 1996. (Exhibit 3)

⁷ Agenda for the San Diego City Council closed session meeting of 19 March 1996. (Exhibit 4)

The City Council went into closed session to discuss the proposed labor contract on 2 April 1996. At the meeting the City Council members were provided a short, numbered list of items that would appear in the proposal which included "Purchase of 5 years Service Credit."

On 2 April 1996, the City hired the Ohio-based law firm, Jones, Day, Reavis & Pogue to "provide legal representation and fiduciary and federal tax implications of the proposed revisions to benefits for the City employees under the San Diego City Employees' Retirement System."

The proposal appeared back before the City Council in closed session on 9 April 1996. There is no record, however, of what was said at the meetings. The City Council further discussed the meet and confer labor negotiations in closed session meetings on 16 April 1996 and 23 April 1996. No minutes were taken for either meeting.⁸

At the 18 April 1996 meeting of the SDCERS Board President, Enerson told the panel that a "special meeting" would be set for 2 May 1996 to discuss the proposal from the City Manager's office.⁹

Before the special meeting, the City received a letter from fiduciary counsel, Jones, Day Reavis & Pogue, which outlined the City's fiduciary duty to the trust and to retirees. Jeffery Leavitt, attorney for the firm, outlined the trustees' duties:

In the context of public pension systems, the California Constitution specifically defines the fiduciary duties of the retirement board or board of administrations:

Notwithstanding any other provisions of law or this Constitution to the contrary, the retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system...(a)...The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.¹⁰

⁸ Minutes of the 16 April 1996 closed session meeting of the San Diego City Council. (Exhibit 5)

⁹ Minutes of the 18 April 1996 meeting of the San Diego City Employees Retirement System Board of Administrators. (Exhibit 6)

¹⁰ 29 April 1996. Letter from Jeffery Leavitt, attorney for Jones, Day, Reavis & Puge to Bruce Herring, deputy city manager for the City of San Diego. Carbon Copied: John Kaheny. Re: "Fiduciary Aspects of Plan Revision." (Exhibit 7)

The City was hereby notified that a fiduciary duty to the retirees and the duty to maintain and ensure the financial integrity of the trust fell squarely on the Board of Administrators at SDCERS. The letter was addressed to former Deputy City Manager Bruce Herring and was carbon copied to Assistant City Attorney John Kaheny. This fact is important because the San Diego City Attorney's office served as the general counsel to SDCERS. The City Attorney's office had been put on notice of its fiduciary responsibility to protect the financial integrity of the trust.

The City sent another draft of Manager's Proposal I to the retirement system on 29 April 1996 which spelled out which employees would be eligible to buy credits:

Purchase of Service Credit: Continue the existing service credit provisions related to refunds, probationary periods, 1981 Plan waiting period and Military & Veteran Code; incorporate all others into new a general provision of a five (5) year purchase of service credit feature for any prior public service, which would also be available to ½ time and ¾ time employees...¹¹

The proposal also included language on how the pension credits would be priced, paid for, and how much this benefit would cost the City. Specifically, the report stated that the cost of the benefit for employees would be "discounted." The report stated:

Provide a one-time purchase of service credit to plan members with fifteen (15) or more years of creditable service as of July 1, 1996. Participants may elect, by December 31, 1996, to purchase up to five (5) years of service (described above) **at a discounted rate** subject to the individual employee's IRS 415 limitations. Options for funding the employee's share (e.g. 401k, SPSP funds, accrued annual leave) are being analyzed by legal counsel. The employer's share will be funded (not amortized) from surplus earnings. **The total cost to the City of this discount will be set at \$6 million dollars.** If the calculated cost to the City exceeds \$6 million when the total population of those opting for these benefits is known, each employee's request will be reduced proportionally down to the \$6 million level.¹² (emphasis added)

The proposal states that City employees would be permitted to purchase years to increase their retirement benefits for less money than it costs the City to pay the benefit. In other words, the City Manager proposed creating an unfunded benefit. Moreover, the money to pay for the discounted benefit was to be drawn from "surplus earnings," which represents gains on retirement system investments.

¹¹ 29 April 1996. Memorandum to City Employees Retirement System. "Concept Overview." (Exhibit 8)

¹² 29 April 1996. Memorandum to City Employees Retirement System. "Concept Overview." (Exhibit 8)

Another draft of the proposal was sent out to SDCERS Board members and officials days before the special meeting, scheduled for 2 May 1996. This draft did not include the language that appeared in the 29 April 1996 letter regarding how the years of service would be priced and the cost to the City. The draft stated,

Purchase of Service Credit: Continue the existing service credit provisions related to refunds, probationary periods, 1981 Plan writing period and Military & Veteran Code; incorporate all others into a new general provision of a five (5) year purchase of service credit feature for any prior public service, which would also be available to ½ time and ¾ time employee. Employees would pay into retirement fund an amount, including interest, equivalent to the employee and employer full cost of such service.¹³

The proposal marked the first time the plan stated that the cost of the credit for the employee would include “the employee and employer full cost of such service.”

Jack McGrory, former city manager, appeared at the 2 May 1996 special meeting and delivered a PowerPoint presentation that included proposed information about the purchase of service plan. This meeting marks the first time the proposal by McGrory had been made available to the public. In describing the proposed PSC program, McGrory stated that “Employee Pays for Employer and Employee Costs.”¹⁴ Attendees of the meeting included Cathy Lexin, human resources manager for the City and one of the main negotiators in the meet and confer process; Judie Italiano, head of the Municipal Employees Association; and Deputy City Attorney John Kaheny.

The City went back into closed session on 7 May 1996 with the municipal union leadership to discuss and negotiate the proposal.¹⁵ The same PowerPoint presentation was shown at the closed session, also including that “Employee Pays for Employer and Employee Costs.”¹⁶

¹³ 2 May 1996. City Employees Retirement System. “Concept Overview. (Exhibit 9)

¹⁴ Minutes of the 2 May 1996 meeting of the SDCERS Board of Administrators. (Exhibit 10)

¹⁵ Agenda of the 2 May 1996 closed session meeting of the San Diego City Council. (Exhibit 11)

¹⁶ Minutes of the 2 May 1996 closed session meeting of the San Diego City Council. (Exhibit 12)

The City Council met with the municipal unions two more times – on 13 May 1996¹⁷ and 14 May 1996¹⁸ – to discuss the issue before it appeared back before the SDCERS Board at the regularly scheduled meeting on 15 May 1996. In both meetings, the record keeper stopped taking minutes when the meet and confer item came up.¹⁹

At this point, minimal discussion had taken place to specify how the years of service would be priced for employees.

In a 21 May 1996 e-mail from City Auditor Ed Ryan to Deputy City Attorney Sharon Marshall, Ryan specifically questioned how the purchase of service would be priced. He also raised direct concerns that it could represent an unfunded benefit and result in a cost on the City. Ryan wrote,

sharon, [sic] the following would be my questions or comments...Have [sic] it been determined that the purchase is beyond the 5 year program?...Just a reminder that this proposal is one that causes a fiscal impact for a benefit presently no funded. Before proceeding far we should get a fiscal impact.²⁰

Ryan would repeat his concern about the service credits cost for the City in a later draft of the proposal dated 28 May 1996. The proposal mirrored former proposals and said, “Employees would pay into the retirement fund an amount, including interest, equivalent to the employee and employer full cost of service.” Ryan, however, hand-wrote in after this sentence, “This is...implemented at no cost to the City.”

The City Council met in closed session on 28 May 1996²¹ and again on 4 June 1996²² for meet-and-confer negotiation sessions. Neither plan included the changes as suggested by Ryan.

¹⁷ Agenda of the 13 May 1996 closed session meeting of the San Diego City Council. (Exhibit 13)

¹⁸ Agenda of the 14 May 1996 closed session meeting of the San Diego City Council. (Exhibit 14)

¹⁹ Minutes of the 14 May 1996 closed session meeting of the San Diego City Council. (Exhibit 15)

²⁰ 21 May 1996. E-mail from Ed Ryan, city auditor, to Sharon Marshall, deputy cit attorney. Re: draft. (Exhibit 16)

²¹ Minutes of the 28 May 1996 closed session meeting of the San Diego City Council. (Exhibit 17)

²² Agenda of the 4 June 1996 closed session meeting of the San Diego City Council. (Exhibit 18)

On 6 June 1996, McGrory issued a memo to Mayor Susan Golding and the San Diego City Council announcing that the labor unions had tentatively agreed on the benefit improvement package.²³ The service credit language approved in the deal stated:

Purchase of Service Credit: Continue the existing service credit provisions related to refunds, probationary periods, 1981 Plan waiting period and Military & Veteran Code; incorporate all others into a new general provision of five (5) year purchase of service credit feature, which would also be available to ½ time and ¾ time employees. Employees would pay into the retirement fund an amount, including interest, equivalent to the employee and employer full cost of such service.

McGrory appeared back before the retirement board an 11 June 1996 workshop to present the proposal. McGrory specifically stated in his presentation that the cost of purchase of service should be cost neutral to the City. The official minutes from the meeting state, "Mr. McGrory summarized the proposal stating that it offers...a wider purchase of service program at no additional cost to the City..."²⁴

At the meeting, Grissom said that the implementation and pricing of the program had not been established. According to the meeting minutes, Grissom said "that the administrative details on how to accomplish this have not been worked out."²⁵

The most intricate outline of how the plan would be designed appeared in a memorandum from Grissom to the Retirement Board of Administration on 12 June 1996. The language outlines that the plan will remain in effect as it originally stood: allowing certain employees that meet specific criteria to purchase years of service that they worked part time or missed as a result of military service. Grissom wrote:

- b. In addition to period identified above, employees may purchase five years of service by paying both employee and employer contributions

²³ 6 June 1996. Memorandum from Jack McGrory, city manager, to Honorable Mayor and City Council. Subject: "Labor Negotiations – FY98 Tentative Agreements". (Exhibit 19)

²⁴ Minutes of the 11 June 1996 San Diego City Employees' Retirement System workshop. (Exhibit 20)

²⁵ Minutes of the 11 June 1996 San Diego City Employees' Retirement System workshop. (Exhibit 20)

in an amount and manner determined by CERS Board to make the system whole for such service time.²⁶

The proposal, at this point, explicitly states that the purchase of service credits should not create a debt for SDCERS, or as Grissom wrote the cost should be “an amount...to make the system whole for such service time.”²⁷

On 21 June 1996, Grissom received a letter from Dwight Hamilton, attorney for law firm Frandzel & Share which served as fiduciary counsel to SDCERS. Hamilton opined on the SDCERS Board’s fiduciary duty. Hamilton specifically outlined the Board’s responsibility in administering the PSC program:

Once the benefit changes are in effect, the Board of Administration has the plenary authority and fiduciary responsibility to administer the System...and to make such revisions in rates of contribution of members as it deems necessary to provide the benefits that have been granted.²⁸

The opinion letter emphasized that the trustees of a municipal pension have a fiduciary obligation to ensure the System is fully funded. Again, the Board was notified of its duty to maintain the financial integrity of the SDCERS trust.

The SDCERS Board met to discuss MP I and approved it at the 21 June 1996 meeting by a vote of 8-to-3, with Trustees Jack Katz, Ann Parode, and Paul Barnett in opposition.²⁹ Board Trustees that voted in support of the motion included Keith Enerson, Ron Saathoff, Bruce Herring, John Casey, Sharon Wilkinson, Terri Webster, Conny Jamison, Robert Scannell, and John Torres. Specifically, the Board approved a funding relief plan that set the City’s annual contributions to SDCERS below the required amount. The Board also approved the using of “surplus earnings” to pay for benefits.

The City Council approved the package on 2 July 1996 by a vote of 9-to-0, with supporting votes from Council members Mathis, Wear, Kehoe, Stevens, Warden, Stallings, McCarty, Vargas and Mayor Golding. The Council approved a series of

²⁶ 12 June 1996. Memorandum from Lawrence Grissom, SDCERS Administrator, to Retirement Board of Administration. Subject: “Actions Relating to the City Manager’s Proposals.” (Exhibit 21)

²⁷ 12 June 1996. Memorandum from Lawrence Grissom, SDCERS Administrator, to Retirement Board of Administration. Subject: “Actions Relating to the City Manager’s Proposals.” (Exhibit 21)

²⁸ 20 June 1996. Draft letter from Hamilton & Faatz to Lawrence Grissom, Retirement Administrator for SDCERS. (Exhibit 22)

²⁹ Minutes of the 21 June 1996 meeting of the San Diego City Employees’ Retirement System Board of Administrators. (Exhibit 23)

retirement benefit increases that included the expansion of the purchase of service programs. The language stated:

Purchase of Service Credits: Continue the existing service credit provisions related to refunds, probationary periods, 1981 Plan waiting period and Military & Veteran Code; incorporate all others into a new general provision of five (5) year purchase of service credit feature, which would also be available to ½ time and ¾ time employees. Employees would pay the retirement fund an amount, including interest, equivalent to the employee and employer full cost of such service.³⁰

The new program which now enabled a City employee to purchase five years of retirement service – without actually working them – was now established in the City of San Diego Municipal Code.

The City Council was now tasked with passing the Ordinance to enact the purchase of service credit benefit. Once complete, the SDCERS Board would price the years and then the program would become available to employees.

A draft of the ordinance was presented to the City Council in a closed session meeting on 10 December 1996. The proposed ordinance outlined the “General Provision for Five Year Purchase of Service Credit.” The proposal stated, “Any person employed by the City of San Diego on the date of December 31, 1996 may purchase up to a maximum of five years of service credit.” The proposal also addressed how the years of service would be priced by the SDCERS Board. The ordinance stated:

The cost of service credit purchased pursuant to this section shall be calculated on the basis of employer and employee contribution rates and interest rates in effect at the time the purchase is made in accordance with rules prescribed by the board.³¹

Notably, the draft ordinance stated that each year of service credit would be priced based on the employee’s salary plus “interest rates” as identified by the SDCERS board. The draft included no information on exactly what “interest rate” the employee would be charged.

Another draft of the ordinance was provided to the City Council on 25 February 1997. The draft stated:

³⁰ 23 June 1996. Memorandum from Lawrence Grissom, Retirement Administrator, to Cathy Lexin, Labor Relations Manager. Subject: City Manager’s Retirement Proposal. (Exhibit 24)

³¹ Draft “Strikeout Ordinance” for Discussion at the 10 December 1996 meeting of the San Diego City Council. (Exhibit 25)

The cost of service credit purchased pursuant to this section shall be the amount determined by the Board to be the equivalent to the employee and the employer cost of that service credit.³²

The language that included an “interest rate” was notably dropped from the ordinance. Importantly, the ordinance included new language that required that the years of service be priced at an “amount determined by the Board to be the equivalent to the employee and the employer cost” of the benefit.

The City Attorney believes that this draft raised two important issues: First, the City Council ordinance stated that the benefit would be paid entirely by employees. Second, the cost of the benefit would be processed by the Board, whereby the SDCERS Board was given the authority to grant a benefit – a power legally vested to elected officials by the City Charter. These issues will be discussed in greater detail below.

The San Diego City Council unanimously adopted the ordinance on 25 February 1997 by a 7-to-0 vote, with Council members Christine Kehoe and Barbara Warden absent.³³

The San Diego City Attorney believes that the City Council’s decision to give decision making authority to political appointees that was previously exercised by, and legally reserved to, elected officials is a clear violation of the City Charter.

As set forth in San Diego City Charter Article IX, the San Diego City Council is vested with the authority to set retirement benefits administered by the San Diego City Employees’ Retirement System.

Under the language set forth in San Diego City Council ordinance O-18383, employees and retirees are eligible to purchase a retirement benefit priced by the SDCERS Board. The Board, in short, is in the position to set the price excessively low, transferring the cost to the City, and granting the employee or retiree a retirement benefit that was not paid for or earned. The City Attorney will show in this report that the SDCERS Board knowingly and intentionally priced the service credits below the actual cost thereby transferring a liability to the City.

³² San Diego City Council Ordinance O-18383. Section 24.1312. Adopted 25 February 2006. P. 36. (Exhibit 26)

³³ Minutes of the San Diego City Council meeting of 25 February 1997. Council members supporting the adoption of O-18838 included Council member Harry Mathis, Byron Wear, George Stevens, Valerie Stallings, Judy McCarty, Juan Vargas, and Mayor Susan Golding. (Exhibit 27)

III.

ORIGINAL PRICING OF SERVICE CREDITS BY SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM BOARD

Following the City Council approval of the purchase of service credit program, the SDCERS board began the task of pricing the credits.

On 3 March 1997, Rick Roeder, the SDCERS actuary, wrote a letter to Grissom suggesting the pricing to purchase service credits. In the letter, Roeder points out that in an earlier meeting the SDCERS Board suggested "an approach that would charge General members a cost of 15 percent of current pay per year purchased. The corresponding cost for Safety employees would be 26 percent of current pay."³⁴

Under this pricing scheme, a general member earning \$100,000 per year could buy a year of pension credits for \$15,000.

Roeder warned that "[t]hese rates are slightly less than the sum of the average employees rate" and suggested that General members pay 17.12% of current pay per year purchased and Safety members pay 29.55% of current pay per year purchased.³⁵ He specifically notified the Board that anything less than his suggested rate would lead the City paying a "significant subsidy" to pay for the benefit. Roeder, however, opined in the letter that a 15 percent rate for general members and 26 percent of salary for safety members would be sufficient. He wrote:

If the proposed purchase rates are used, we believe that the overall cost will be close enough to true actuarial costs so that there will not be a significant subsidy of the proposed percentages that are used.³⁶

The SDCERS board decided on the pricing of the service credits on the 21 March 1997 meeting. The board noted that the recommendation of the actuary was for the

³⁴ 3 March 1997. Letter from Rick Roeder, SDCERS outside actuary, to Lawrence Grissom, retirement administrator. (Exhibit 28)

³⁵ 3 March 1997. Letter from Rick Roeder to Lawrence Grissom. (Exhibit 28)

³⁶ 3 March 1997. Letter from Rick Roeder to Lawrence Grissom. (Exhibit 28)

employee to pay “the combined employee and employer contribution rates.”³⁷ The SDCERS Board approved the rate by a unanimous vote.³⁸

The SDCERS Board was now responsible to ensure that the program was cost neutral for two reasons:

- a. San Diego Municipal Code Ordinance O-18383, as approved by the City Council on 25 February 1997, stated that the cost was to be set at an “amount determined by the Board to be the equivalent to the employee and the employer cost of that service credit.”³⁹ In short, the service credits should be cost neutral to the City and SDCERS.
- b. As fiduciaries, the SDCERS Board’s main responsibility is to protect the financial integrity of the trust thereby ensuring that the benefit was not an unnecessary drain on SDCERS and creating an unfunded liability.

The City Attorney will provide evidence in this report to support a conclusion that the SDCERS Board failed to fulfill both of these responsibilities.

IV.

THE DEBT CONTINUES TO GROW

The PSC program became a big sales item for the San Diego City Employee’s Retirement System. City employees were given the opportunity to increase retirement benefits for life by buying years of service without having to work them – all at a discount price.

It was not long until the cost of this subsidy began to catch up with the SDCERS Board. In the June 30, 2001 valuation for the retirement system, the system’s actuary issued a warning that the program was not cost neutral and that the SDCERS was incurring debt by setting service credits at a discounted rate. The valuation, issued to the Board on 12 February 2002, stated:

³⁷ Transcript of the 21 March 1997 meeting of the San Diego City Employees’ Retirement Board meeting. The transcription was taken from tapes of the meeting. The individual believed to have spoken in the quote is Lawrence Grissom, then administrator for the San Diego City Employees’ Retirement System. (Exhibit 29)

³⁸ Minutes of the 21 March 1997 meeting of the San Diego City Employees’ Retirement System Board of the Administrators. (Exhibit 30)

³⁹ San Diego City Council Ordinance O-18383. Section 24.1312. Adopted 25 February 2006. P. 36. (Exhibit 31)

We are recommending that we receive service credit data for service purchases. Currently, valued liabilities for active members are understated to the extent that they have purchased service.⁴⁰

The valuation also pointed that the funded ratio for SDCERS had grown to 89 percent⁴¹, a significant decline from the 97 percent funded ration as presented in the City's Blue Ribbon Committee Report on Finances.⁴² In other words, SDCERS had funds to pay 89 cents for every dollar owed to retirees and current employees.

The valuation raised concerns within SDCERS and provoked Paul Barnett, assistant retirement administrator, to write a letter to the Board echoing Roeder's concerns that the program is not cost neutral. Barnett suggested that the pricing method be adjusted in a 5 May 2002 letter.

Staff is recommending that the Purchase of Service (PSC) rules be amended to standardize both the types of service credit available for purchase and the calculation method used to 'price' this product. The reason for this recommendation include re-pricing the cost of PSCs to more accurately reflect the actuarial impacts of service purchase....The other important point to note about current PSC rules is the negative actuarial impact...Staff strongly urges the Retirement Board to update its PSC calculation methodology to reflect the true cost of purchasing service credit⁴³

Barnett pointed to one of the specific problems with the pricing:

[C]ontributions...would be priced using the member's current salary at the time of application times a factor determined each year by the Actuary that reflects current benefit level. Rick Roeder has reviewed the concept of PSC simplification, and agrees that the current pricing method contains actuarial inequities.

⁴⁰ San Diego City Employees' Retirement System Annual Actuarial Valuation June 30, 2001. P. 17. (Exhibit 32)

⁴¹ San Diego City Employees' Retirement System Annual Actuarial Valuation June 30, 2001. P. 13. (Exhibit 32)

⁴² Mayor's Blue Ribbon Committee Report on Finances. (Exhibit 33)

⁴³ 5 May 2002. Letter from Paul Barnett, assistant retirement administrator, to Business and Procedures Committee. (Exhibit 34)

The problem, as identified by Roeder, is that younger employees who purchased credits were paying the same as older employees and the payment of the elder employees PSC benefit enhancement costs were heavily subsidized by SDCERS.

According to Roeder, the program was originally cost neutral when a general member employee pays the 15 percent or a safety member pays 26 percent of current salary and that money is invested for a sufficient time to collect interest to cover the payments when the employee retires. Roeder pointed out that an older employee that purchased the service credits closer to retirement does not allow the money ample time to gain interest, leaving an unfunded deficit that SDCERS or the City must pay. In other words, SDCERS and the City subsidizes the PSC benefit for older PSC buyers.

In other words, purchasing service credit when an individual is closer to retirement and the System has less time to earn interest in the funds received requires a higher PSC cost to that member than to an individual who has several years remaining before retirement benefits are paid.⁴⁴

Barnett pointed out that Roeder suggested a solution: creating a tiered pricing program where employees that purchase service credits closer to retirement pay more. Barnett wrote:

[Roeder] has proposed new PSC calculation factors for General and Safety members based on the member's age at the time of application, less than 40 years old, 40 to 50 years old and over 50 years old...The PSC calculation factors increases the time between a member's purchase of service and the expected retirement age when benefits will be paid decreases.

The letter included recommended rates to create a cost neutral purchase of service program.⁴⁵

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⁴⁴ 5 May 2002. Letter from Paul Barnett, assistant retirement administrator, to Business and Procedures Committee. (Exhibit 34)

⁴⁵ 5 May 2002. Letter from Paul Barnett, assistant retirement administrator, to Business and Procedures Committee. (Exhibit 34)

Attained Age Band	% of Current Pay Per Service Year
20 – 24	11.3%
25 – 29	13.1%
30 – 34	14.7%
35 – 39	17.1%
40 – 44	19.1%
45 – 49	22.2%
50 – 54	25.9%
55 – 59	30.2%
60 – 64	30.7%
65+	29.3%

Attained Age Band	% of Current Pay Per Service Year
20 – 24	17.6%
25 – 29	20.5%
30 – 34	22.9%
35 – 39	26.7%
40 – 44	31.1%
45 – 49	36.2%
50 – 54	40.6%
55 – 59	40.1%
60 – 64	37.5%
65+	34.3%

It is important to emphasize that at this point, in May 2002, the price for general members year of service was 15 percent and for safety members a year of service cost 26 percent. The percentages in Roeder's proposed graphs provide a good illustration the deep discount in the pricing.

For example, under Roeder's recommendation a 55 year-old city employee that makes \$100,000 annually would pay \$30,200 for one year of service. This is critically important because, as Roeder points out in his letter, the older employees are the individuals that the System subsidizes heavily. In contrast, under the old PSC pricing methodology, this individual pays \$15,000 for one year of PSC – a \$15,200 difference that becomes a liability to SDCERS.

The SDCERS Board scheduled a discussion of Barnett's suggestion at the 24 May 2002 meeting.⁴⁶

At the meeting, Grissom told SDCERS trustees out that the pricing of the retirement benefits is not cost neutral. Grissom said:

From an actuarial or funding point of view the other main point is that...purchase of services are being made at yester-, you know today's benefits but yesteryear's prices.⁴⁷

Grissom pointed out that the City and its labor unions were in the meet-and-confer process, where salary adjustments and potential retirement benefit enhancements are discussed for a new labor contracts for City workers. The meet-and-confer process in 2002 would later result in the deal between the City, labor unions, and retirement board known as Manager's Proposal II. The deal resulted in a significant benefit increase for retirees. At the meeting, Grissom alluded to these discussions and the possibility that further retirement benefit enhancements would result SDCERS and the subsidizing more PSC purchases. Grissom said:

So there's a gap and given the most recent meet and confer...now we are, we are talking about the benefit going up slightly again. So the gap only widens. So you've got a cost of product that doesn't reflect the benefit being received. And in between those two issues, the administrative complexities and the cost differential, we really feel this issue needs to be addressed if we're to, to both provide good service and, and fund, and keep the fund [inaudible] what it should be.⁴⁸

⁴⁶ Agenda of the 24 May 2002 meeting of the San Diego City Employees' Retirement System Board of Administrators. (Exhibit 35)

⁴⁷ Transcript of the 24 May 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. The transcription was taken from tapes of the meeting. The individual believed to have spoken in the quote is Lawrence Grissom, then administrator for the San Diego City Employees' Retirement System. (Exhibit 36)

⁴⁸ Transcript of the 24 May 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. The transcription was taken from tapes of the meeting. The individual believed to have spoken in the quote is Lawrence Grissom, then administrator for the San Diego City Employees' Retirement System. (Exhibit 36)

Terri Aja Webster,⁴⁹ a Board member and former assistant city auditor, said at the meeting, the Board has a fiduciary obligation to make changes to the service credit pricing now that a concern has been raised. Webster said:

Oh, as, fiduciaries, you know once we have the information that the current method is not, is not covering the costs, I, I feel we have no choice but to change it. It's, it's the, the cost to live up to employees but we have, we have, I don't think we have any other option as fiduciaries but to make a change. So, the, the question is just how, you know how do we, how do we implement the change and, and, and go forward with it.⁵⁰

Grissom echoed Webster's comment that correcting the program to a cost neutral pricing methodology is the fiduciary obligation of the Board. He also said that the cost of the benefit is not a vested benefit for employees and can be changed at the Board's will:

It's my understanding, as we have looked at this, that the cost of benefit is not a vested right and that it is the [inaudible] responsibility of the Board as fiduciaries to establish that cost. And, as we know, costs change over time for a var-, for a variety of reasons. So that, that the actual cost of the benefit is not a vested right and therefore not negotiable, meet-able and conferrable.⁵¹

Despite the concerns and the "strong" recommendation from staff, the Board did not vote on the item and kept the discounted pricing in place. According to the Board minutes, "Mr. Saathoff stated this is a complex issue and will come back for action in June 2002."⁵²

⁴⁹ Terri Aja Webster was indicted by the U.S. Grand Jury on 6 January 2006 for conspiracy to commit wire and mail fraud; wire fraud; mail fraud; and aiding and abetting. (Exhibit 37)

⁵⁰ Transcript of the 24 May 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. The transcription was taken from tapes of the meeting. The individual believed to have spoken in the quote is Terri Aja Webster, former assistant auditor for the City of San Diego and former SDCERS trustee. P. 14. (Exhibit 36)

⁵¹ Transcript of the 24 May 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. The transcription was taken from tapes of the meeting. The individual believed to have spoken in the quote is Lawrence Grissom, then administrator for the San Diego City Employees' Retirement System. P. 32. (Exhibit 36)

⁵² Minutes of the 24 May 2002 meeting of the San Diego City Employees' Retirement System Board of Administrators. P. 23. (Exhibit 38)

Barnett wrote another letter to the SDCERS Board on 11 June 2002⁵³ outlining the proposed modification to the PSC pricing methodology and stressed that the current program is not cost neutral. Barnett wrote:

At the May Board meeting, the attached recommendation for PSC Simplification and a new costing method was introduced....staff continues to recommend that the Retirement Board approve updating PSC calculation methodology to reflect the true cost of purchasing service credit.⁵⁴

Attached to the letter was the same cost breakdown that Roeder devised for the May letter to the Board.⁵⁵

The Board discussed Roeder and Barnett's new proposal at the 19 July 2002 meeting at SDCERS. The concern was raised for the third time that the pricing of the credit was not cost neutral and resulted in a liability to the retirement system. Grissom said:

And focusing on the five year, obviously the City adopted that benefit and put it in the Muni Code with the understanding that it would not increase the liability regarding the five year air time [inaudible.] How the 15 percent was derived at I don't remember obviously. We're finding out there must not have been some solid theory behind it.⁵⁶

Grissom said that because the discounted PSC cost to the System had been brought to the Board's attention that it had a fiduciary obligation to increase the price of the credits.

But now we are aware of this problem it seems like it is our fiduciary duty to fix it 'cause every time that somebody signs a purchase of service contract, or almost every time it seems like, we're increasing the liability to the plan sponsor, which isn't right. And the Board doesn't have the

⁵³ 11 June 2002. Letter from Paul Barnett to Retirement Board, via Lawrence Grissom, Retirement Administrator. Subject: Purchase of Service Credit Simplification – Revised Pricing (Exhibit 39)

⁵⁴ 11 June 2002. Letter from Paul Barnett to Retirement Board, via Lawrence Grissom, Retirement Administrator. Subject: Purchase of Service Credit Simplification – Revised Pricing (Exhibit 39)

⁵⁵ 5 May 2002. Letter from Paul Barnett, assistant retirement administrator, to Business and Procedures Committee (Exhibit 34)

⁵⁶ Transcript of the 19 July 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. The transcription was taken from tapes of the meeting. P. 9-10. (Exhibit 40)

authority to allow subsidizing for the member's purchase...So anyway I do think we should, and this is the third month it's been on the agenda so I, I definitely think we need to take care of it one way or the other...But I, again I do think we need to fix the bleeding.⁵⁷

An interesting point is also brought up by a member of the Board at the meeting. Following the Board's 5 June 1996 meeting where discussions were first aired about the possibility of increasing the price on the PSCs, the System received a flood of requests to purchase. Certain members of the Board pushed for the establishment of a grandfathering period so more people can get in at the discounted price.

'Cause I think it's true and I, I know at least a lot of our members have been, you know there was this June 5th deadline rumor that got out there. And it has more to do with grandfathering [inaudible] purchase of service for the general member system...But it reverberated through the safety ranks too. And they've been inundated with people coming in wanting to make requests 'cause they wanted to lock in a date...We have to have some sort of grandfather period.⁵⁸

At this point, Board members had been told three times that the pricing for the credits was not priced accurately and was increasing the liabilities of SDCERS.

Despite the warnings, the Board voted to continue the item to the August meeting. The City Attorney believes that this delay was another attempt to allow employees to apply for the purchase at the low rate. According to the minutes of the meeting, "Mr. Saathoff stated that the Purchase of Service Simplification and Costing Method was trailed to August with Staff to further research costing through the actuary."⁵⁹

Barnett issued another proposal to the Board on 6 August 2002 that marked a significant change in the proposed costing method. Prior to this memo, Barnett and Roeder had advocated for a pricing method based on age. The logic was that older member's purchases resulted in a liability to SDCER because the money, when invested, would not have sufficient time to cover the cost of the benefit. Barnett stated:

⁵⁷ Transcript of the 19 July 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. The transcription was taken from tapes of the meeting. P. 9-10. (Exhibit 40)

⁵⁸ Transcript of the 19 July 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. The transcription was taken from tapes of the meeting. The individual believed to have spoken in the quote is Ron Saathoff. P. 11. (Exhibit 40)

⁵⁹ Minutes of the 19 July 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. (Exhibit 41)

Originally, the Fund's actuary proposed charging for purchased service based on the member's age at the time of application. This was based on the fact that Purchase of Service contracts are generally less expensive for younger members because there is a longer period of time before the purchased service credit is applied to a retirement benefit. However, this methodology inadvertently penalizes older members who would end up paying significantly more for purchasing a year of service credit than they would pay if they simply were to work.⁶⁰

Barnett's new proposal was strikingly different:

This simplification would include calculating all service purchases using the Member's current salary at the time of application. Upon further review and discussions with the Actuary, staff recommends continuing the cost factor for any purchase of 15% for General Members and 26% for Safety Members (the current cost for 5-year PSCs).⁶¹

In other words, despite the numerous warning from SDCERS staff and Board members of the fiduciary obligation to increase the price, no increase was recommended in the new proposal.

Barnett provided a brief explanation for backtracking on restructuring the pricing to achieve a cost neutral program for the System.

The perceived inequity of these higher purchase factors has caused some discussion with employees groups regarding possible diminishment of benefits. This would likely result in the Board being requested to establish an extensive window period prior to implementation. This would in turn cause the majority of impacted members to complete purchases before the expiration of the window, negating any impact of the proposed changes.⁶²

⁶⁰ 6 August 2002. Letter from Paul Barnett, assistant retirement administrator, to Retirement Board, via Lawrence Grissom, retirement administrator. Subject: Purchase of Service Credit Simplification. (Exhibit 42)

⁶¹ 6 August 2002. Letter from Paul Barnett, assistant retirement administrator, to Retirement Board, via Lawrence Grissom, retirement administrator. Subject: Purchase of Service Credit Simplification. (Exhibit 42)

⁶² 6 August 2002. Letter from Paul Barnett, assistant retirement administrator, to Retirement Board, via Lawrence Grissom, retirement administrator. Subject: Purchase of Service Credit Simplification. (Exhibit 42)

The pricing modification appeared before the SDCER Board at the meeting of 16 August 2002.⁶³ At the meeting, the Board approved keeping the pricing for PSC at 15 percent of salary for general member and 26 percent of salary for safety members.⁶⁴ The only difference, the price would be computed using the employees highest-rate of pay instead of the 12-month average. At the meeting, Grissom noted that the new proposal would not bring the purchase of service to a cost neutral program.

The statement was made, has been made, and has been made in discussions in the past, the purpose of costing purchase of service is to make sure that the system is whole. And I submit to you that that's impossible to do...So, what we need to recognize is that this costing in terms of, of, of coming up with absolute neutrality I don't think there's a number that staff can give you, that the actuary can give you that will actually guarantee that.⁶⁵

As part of the vote at the 16 August 2002 meeting the Board requested that the System's actuary complete an analysis to determine whether the new adjustment "will not detrimentally impact the fund over the current methodology."⁶⁶

Perhaps more disturbing, the SDCERS Board approved allowing employees calculate their purchase under the new cost and the old cost and then keep the cheaper method. The motion approved by the Board stated, "additionally, all applications currently on file at SDCERS or those that have been prepared less than 90-days prior to today will be calculated under both the old and new methodology, with the lesser of the two being executed."⁶⁷ In other words, the SDCERS staff calculates the cost under the new and old methodology and allows the employee to pay the cheaper – all at the expense to the SDCERS.

⁶³ Agenda for the 16 August 2002 meeting of the San Diego City Employees' Retirement System Board of Administrators. (Exhibit 43)

⁶⁴ Minutes of the 16 August 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. The vote was 8-to-2, with Trustees Terri Webster and John Casey in opposition. (Exhibit 44)

⁶⁵ Transcript of the 16 August 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. The transcription was taken from tapes of the meeting. The individual believed to have spoken in the quote is Lawrence Grissom, former administrator of SDCERS. P. 11. (Exhibit 45)

⁶⁶ Minutes of the 16 August 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. (Exhibit 44)

⁶⁷ Minutes of the 16 August 2002 meeting of the San Diego City Employee's Retirement System Board of Administrators. (Exhibit 44)

Roeder sent a letter to Barnett on 20 August 2002 confirming the directive of the Board on the 16 August meeting. In the letter, Roeder repeated concerns that recent raises given to employees and increased retirement benefits granted by the City render the PSC a liability to the System. Roeder also states that the new method will have little effect on the liability being incurred by SDCERS.

We have been asked to render an opinion whether the proposed method would increase or decrease the level of subsidy compared to the more complicated current method. Recognizing that there is limited available data, we believe it likely that the proposed method would either not change or somewhat reduce the level of subsidy that assuredly exists in the current method.⁶⁸

Roeder stated in the letter that a full report of the impact of the new pricing method on the System would be prepared in the next 12 to 28 months.⁶⁹

The San Diego City Council on 18 November 2002 approved a series of retroactive retirement benefit enhancements to employees and retirees of the City.⁷⁰ A major enhancement in retirement benefits was the increase of the “benefit multiplier” from 2.25 percent at 50-years-old to 2.5 percent at 50-years-old.

The “benefit multiplier” is a piece of the mathematical formula SDCERS uses to calculate a retiree’s annual payment. The increase approved by the Council provided a notable boost to retiree’s annual pension payments.

V.

THE DEBT CONTINUES TO GROW 2003—2004

At the turn of the new year, the SDCERS Board immediately received another warning that the pricing of the service credits was too low and that SDCERS was

⁶⁸ 20 August 2002. Letter from Rick Roeder, SDCERS outside actuary, to Paul Barnett, assistant retirement administrator. Re: Actuarial Costs Related To Service Purchase Program. (Exhibit 46)

⁶⁹ 20 August 2002. Letter from Rick Roeder, SDCERS outside actuary, to Paul Barnett, assistant retirement administrator. Re: Actuarial Costs Related To Service Purchase Program. (Exhibit 46)

⁷⁰ Minutes of the 18 November 2002 meeting of the San Diego City Council. (Exhibit 47)

subsidizing the benefit. The SDCERS Board received the 30 June 2002 annual actuarial valuation at its 17 January 2003 Board meeting.⁷¹

The financial analysis presented in the report confirmed all suspicions that the pricing of the service credit was adding debt to SDCERS. The report stated that these purchases have cost SDCERS a total of \$77.7 million. Roeder wrote in the valuation, "The added liabilities associated with the service purchase was \$77.7 million."⁷²

Roeder also included a more detailed analysis of how the number of years purchased.

To date, 994 General member purchased 4,601 years of 'permissive' service... 192 Safety members purchased 618 years of service.⁷³

The actuarial valuation appeared before the SDCERS Board of the 21 February 2003 meeting⁷⁴ and the PSC issue was addressed. SDCERS Board Trustee Diann Shipione pointed out that \$21.3 million dollars worth of years of service had been purchased by employees of the City of San Diego in 2001 alone.

The SDCERS board approved the June 30, 2002 actuarial valuation by a unanimous vote. There was, however, no discussion at the meeting about adjusting the cost of the PSC and its effect on liabilities for the System.

It was not until 16 July 2003 that discussions resumed over the pricing of PSCs. In a 16 July 2003 e-mail exchange between Terri Webster and Lawrence Grissom, both openly discuss the new pricing methodology established at the 16 August 2002 was not cost neutral.

Ok [sic] Larry...since this will be published I want to double check if this statement is accurate....

'As of June 30, 2002 the system has incurred an approximate \$56 million loss due to the under funding of Purchase of Service Credit program. Said another way: since the system is charging 15% for General and 26% for Safety and the true cost is estimated to be over 25% for General and 30%

⁷¹ Minutes of the 17 January 2003 meeting of the San Diego City Employee's Retirement System Board of Administrators. (Exhibit 48)

⁷² San Diego City Employees' Retirement System Annual Actuarial Valuation. June 30, 2002. p. 17. (Exhibit 49)

⁷³ San Diego City Employees' Retirement System Annual Actuarial Valuation. June 30, 2002. p. 17. (Exhibit 49)

⁷⁴ Minutes of the 21 February 2003 meeting of the San Diego City Employees' Retirement System. (Exhibit 50)

for Safety, the system has incurred over \$56 million in losses thru June 30, 2002.⁷⁵

Grissom replied in an e-mail dated 16 July 2006:

Make the Safety amount 'over 35%' and I'm fairly comfortable. Too much going on to nail it down further right now. Larry⁷⁶

The exchange provides further evidence that trustees of SDCERS were aware that the pricing of the PSC program was grossly discounted for employees. An e-mail exchange between Roeder and Webster later in the year would show that Webster's \$56.6 million estimate was too low.

A letter was sent to Grissom and Barnett by Roeder on 6 August 2003 that included the analysis of the PSC pricing methodology that was promised on year earlier.⁷⁷ Roeder's analysis reiterated his earlier reports:

These numbers show that the plan sponsors are currently subsidizing a significant amount of the added liabilities associated with service purchase.⁷⁸

Barnett wrote another letter to the Board on 6 August 2003 echoing Roeder's request and reiterating his prior requests that the Board increase the pricing of the PSC for both general and safety members. Barnett explained that Roeder finished the study to determine a cost neutral price for general members, safety members, and members of the elected officers' retirement plan. At that point, elected officials paid the same rate as general members. Barnett made two suggestions:

⁷⁵ 15 July 2003. E-mail from Terri Webster, former SDCERS Trustee and former assistant city auditor, to Lawrence Grissom, former SDCERS administrator. Subject: "Re: PSC". (Exhibit 51)

⁷⁶ 16 July 2003. E-mail from Lawrence Grissom, former SDCERS administrator, to Terri Webster, former SDCERS Trustee and former assistant city auditor. Subject: "Re: PSC". (Exhibit 51)

⁷⁷ 6 August 2003. Letter from Rick Roeder, SDCERS outside actuary, to Larry Grissom, retirement administrator, and Paul Barnett, assistant retirement administrator. (Exhibit 52)

⁷⁸ 6 August 2003. Letter from Rick Roeder, SDCERS outside actuary, to Larry Grissom, retirement administrator, and Paul Barnett, assistant retirement administrator. (Exhibit 53)

1. Adjust the cost for all City PSC applications received after Board approval to 27% for General Members, 37% for Safety Members and 50% for Legislative Members. These percentages would be applied to the Members current annual salary to determine the purchase price for a year of service credit...
2. Adjust the cost as detailed above 90-days after Board approval and notify the membership of the pending cost increase so that applications received during this 90-day window period would be processed using the 15%/26% cost methodology.⁷⁹

The second recommendation is particularly disconcerting because after numerous warnings that the PSC price was too low over a two year period, SDCERS staff continued to recommend allowing members to purchase the benefit at deep discount. This, as illustrated by evidence presented in this report, results in a direct liability to SDCERS.

In response to Barnett's letter, the SDCERS Board docketed the "Recommendations Regarding the Costs Associated with SDCERS' Purchase of Service Program" for the 15 August 2003 meeting.⁸⁰

In the days preceding the meeting, SDCERS trustees acknowledged their potential legal liability for their failure to adjust PSC pricing in 2002.

Webster sent an e-mail to SDCERS Board Trustee Ray Garnica on 11 August 2003 outlining the importance of increasing the pricing. Webster also told Garnica that the Board may have violated the City's Municipal Code by not increasing the pricing of the PSC in 2002. Webster wrote:

Want to make sure you understand it and the importance of 'fixing the problem'.

In summary...The City created a benefit of buying 5 years of 'air time' in 1997. The Board was to administer it in a cost neutral manner. Instead the program has been administered by the Board at a loss...to the Fund...which means to the City...which increases UAAL and employer rates and lowers the funding ratio.

From 1997 thru 6-30-02 Rick, our actuary, estimates the 'loss' to be **\$56 million...**

⁷⁹ 6 August 2003. Letter from Paul Barnett, assistant retirement administrator, via Lawrence Grissom, retirement administrator. To: Retirement Board, via Business Procedures Committee. Subject: Purchase of Service Credit Cost Analysis. (Exhibit 53)

⁸⁰ Agenda for the 15 August 2003 meeting of the San Diego City Employees' Retirement System Board of Administrators. (Exhibit 54)

So the mis-administration of the PSC program by the Board is more than the 'underfunding' issue!...

Rick Roeder, at least a year ago, advised the Board it was being administered at a loss.

Terri⁸¹

Webster's e-mail provides evidence that SDCERS trustees were aware of the problems with the PSC pricing method. Trustees were also cognizant of their non-compliance with their duty to administer the fund as specified in the City of San Diego Municipal Code.

Webster sent an e-mail to Roeder on 13 August 2006 to rehearse questions for the 15 August meeting and establish the numerical value of the SDCERS liability resulting from discounted PSC pricing was. Webster wrote:

Rick...I wanted you to confirm what the \$56.4 number represents....I was told it was the 'underfunding' of the permissive 5 year buy back.⁸²

In a reply, Roeder wrote the actual liability created by the PSC program is \$77.7 million.

The \$77 million represents our calculations since inception of the 5-year service purchase program (clearly prior to 6/30/01) for all purchasers who are STILL active members as of 6/30/02...The \$77 million is LESS than the related gross total liability for the 5-year service purchase program.⁸³

The SDCERS Board discussed the PSC pricing issue at the meeting of 15 August 2003. The motion, made by trustee Ronald Saathoff⁸⁴ and trustee Cathy Lexin,⁸⁵ was to

⁸¹ 11 August 2003. E-mail from Terri Webster, former SDCERS trustee and former assistant city auditor, to Ray Garnica, former SDCERS trustee. Subject: PSC. (Exhibit 55)

⁸² 13 August 2003. E-mail from Terri Webster, former SDCERS trustee and former assistant city auditor. Subject: "Re: Service Purchase". (Exhibit 56)

⁸³ 14 August 2003. E-mail from Rick Roeder, former SDCERS actuary, to Terri Webster, former SDCERS trustee and former assistant city auditor. Subject: "Re: Service Purchase". (Exhibit 56)

⁸⁴ Ronald Saathoff, former SDCERS trustee and president of the San Diego Firefighters Association Local 145, was indicted by the U.S. Grand Jury on 6 January 2006 for conspiracy to commit wire and mail fraud; wire fraud; mail fraud; and aiding and abetting. (Exhibit 37)

approve Barnett's second recommendation to increase pricing to "27% for General Members, 37% for Safety Members and 50% for Legislative Members" and allow a 60-days after Board approval and notify the membership of the pending cost increase so that applications received during this 60-day window period would be processed using the old PSC pricing methodology.

Under this new pricing, a general member earning \$100,000 annually could purchase one of PSC for \$27,000 – a total of \$12,000 more than the old pricing.

The motion was met with immediate argument by trustee Richard Vortmann, who according to the meeting minutes, "asked about the pricing. He said it appears to be analogous to an annuity and doesn't look to be cost neutral program, nor will it ever be. Thus, he doesn't understand why employees are being given a 60 day notice."

According to the minutes, trustee Steven Meyer said "the idea of a 60-day notice would give members time to get their contracts submitted. However, he asked if the cost to purchase would be borne by the member."

Saathoff said the cost would be born by the members.⁸⁶

Flying in the face of Saathoff's response to the question, Roeder immediately followed and repeated his warning the PSC pricing method in place would not cover the cost of SDCERS' payment of the benefit. According to the minutes:

Mr. Roeder said that 15% rate for general members and legislative members and the 26% rate for safety members is not sufficient to finance this program on an actuarially meaningful basis. The purchase of these benefits puts upward pressure on both the unfunded accrued liability and on the amortization of the liability.

Despite this repeated warning by Roeder, the SDCERS Board approved the increased PSC pricing but allowed for the 60-window for employees to buy credits under the old pricing methodology.⁸⁷

⁸⁵ Cathy Lexin, former human resources director for the City of San Diego, was indicted by the U.S. Grand Jury on 6 January 2006 for conspiracy to commit wire and mail fraud; wire fraud; mail fraud; and aiding and abetting. (Exhibit 37)

⁸⁶ Minutes of the 15 August 2003 meeting of the San Diego City Employees' Retirement System Board of Administrators. (Exhibit 57)

⁸⁷ Minutes of the 15 August 2003 meeting of the San Diego City Employees' Retirement System Board of Administrators. (Exhibit 57)

Shortly after the meeting, the staff at SDCERS sent a notification to all city employees alerting them that PSC purchase application received by SDCERS prior to 1 November 2003 will be priced under the old methodology – 15 percent for general and legislative members and 26 percent for safety members.⁸⁸

The City Attorney believes that postponing the implementing for nearly two years after the Board was originally notified that SDCERS was subsidizing employee purchase of PSC is a violation of the trustees' fiduciary duty and the San Diego Municipal Code.

Meanwhile, the liability to SDCERS that was created by the discounted PSC pricing continued to grow. According to the SDCERS June 30, 2003 annual actuarial valuation, more general members purchased 6,157 years of service and safety members purchased an additional 948 years of service.⁸⁹ The valuation also stated that SDCERS liability as a result of the discounted PSC was \$12.7 million⁹⁰ Roeder also predicted "that there will be one more year of significant, actuarial losses until the new, hire purchase rates largely mitigates losses in the future."

VI. CONCLUSION

Based upon the evidence presented in this report, it the City Attorney's considered judgment that legal action need to be taken to correct the misappropriation of public funds used to subsidize the illegal pricing scheme for the Pension of Service Credit program.

By _____
Michael J. Aguirre
City Attorney

⁸⁸ Notification from SDCERS to all City employees. (Exhibit 58)

⁸⁹ San Diego City Employees' Retirement System Annual Actuarial Valuation. June 30, 2003. P. iv. (Exhibit 59)

⁹⁰ San Diego City Employees' Retirement System Annual Actuarial Valuation. June 30, 2003. P. 10. (Exhibit 59)

OFFICE OF
THE CITY ATTORNEY
CITY OF SAN DIEGO

MICHAEL J. AGUIRRE
CITY ATTORNEY

CIVIL DIVISION
1200 THIRD AVENUE, SUITE 1620
SAN DIEGO, CALIFORNIA 92101-4178
TELEPHONE (619) 236-6220
FAX (619) 236-7215

July 31, 2007

John Davies, Chair
Charter Review Committee
City of San Diego
202 West C Street, 12th Floor
San Diego, California 92101

Dear Mr. Davies:

Charter Review Committee - Charter Section 40

This letter is to advise you of our concern with the Charter Review Committee's proposed discussions of the City Attorney under Charter section 40. We believe such discussions are outside the scope of the Committee's described duties. We also object to the discussions because the City Attorney was not afforded an opportunity to nominate representatives to the Committee and therefore, lacks representation on the Committee with respect to any Charter section 40 recommendations.

The purpose of the Committee as described in the Mayor's March 20, 2007 memorandum is to make recommendations to "clarify existing trouble spots with the Charter." The memorandum proposed subcommittees to consider issues related to: (1) financial reform; (2) duties of elected officials; (3) interim strong mayor; and (4) permanent strong mayor. In particular, the Duties of Elected Officials subcommittee is to consider the "roles and responsibilities of elected officials and the separation of powers under strong mayor," such as budget authority.

As the subcommittees began to focus on specific charter sections, Charter section 40 was added to the work plan for the Duties of Elected Officials subcommittee. Charter section 40 deals with the responsibilities of the City Attorney. Under the new "Strong Mayor" form of governance, there were no changes in the City Attorney's roles or responsibilities. Charter section 265(b)(2) regarding the Mayor's duties, states: "Nothing in this section shall be interpreted or applied to add or subtract from powers conferred upon the City Attorney in Charter sections 40 and 40.1." Accordingly, a review of Charter section 40 appears to be outside the scope of the Committee's mission and responsibilities.

The Charter Review Committee was established by the Mayor in March 2007. It is our understanding that the Mayor selected seven members on his own and solicited nominations from each Councilmember for his selection of the other eight members. The City Attorney was the only elected official not given the opportunity to nominate members to the Committee. The City Attorney is elected City-wide and commensurate representation on the Committee would have been appropriate. Accordingly, we question the fairness of discussions involving the City Attorney without representation on the Committee.

The City Attorney has submitted proposed changes to Charter section 40 to the City Clerk for consideration by the Rules Committee later this year. Under these circumstances, the Rules Committee is a more appropriate forum for discussions of revisions to Charter section 40. While we applaud your efforts to recommend Charter changes related to financial reforms and various strong mayor issues, we respectfully decline to participate in discussions related to Charter section 40.

Sincerely yours,

MICHAEL J. AGUIRRE, City Attorney

By

Michael J. Aguirre
City Attorney

MJA:jb

cc: Mayor Jerry Sanders
Michael McDade, Chair, Duties of Elected Officials Subcommittee

Exhibit 16

FILED
STEPHEN THUNBERG
Clerk of the Superior Court

MAY 17 2000

BY BARBARA J. JONES, Deputy
Clerk of the Superior Court

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF SAN DIEGO

WILLIAM J. CORBETT; DONALD B.
ALLEN; LEONARD LEE MOORHEAD;
and GORDON L. WILSON; individually, and
on behalf of all others similarly situated,

Plaintiffs,

v.

CITY EMPLOYEES' RETIREMENT SYSTEM;
and DOES 1 through 50, inclusive,

Defendants.

CITY OF SAN DIEGO,

Real Party in Interest.

CITY EMPLOYEES' RETIREMENT SYSTEM
and CITY OF SAN DIEGO,

Cross-Complainants,

v.

WILLIAM J. CORBETT; DONALD B.
ALLEN; LEONARD LEE MOORHEAD;
AND GORDON L. WILSON; individually
and on behalf of all others similarly situated,
and DOES 1 through 10,000, inclusive,

Cross-Defendants.

CASE NO: 722449

I/C Judge: Robert E. May
Dept: 63
Action Date: July 16, 1998

~~PROPOSED~~
ORDER AND JUDGMENT
APPROVING SETTLEMENT
OF CLASS ACTION

~~Proposed~~ Order and Judgment Approving Settlement of Class Action

Int MSJ 000650

0930-0001



1 AND RELATED COMPLAINTS)
2 IN INTERVENTION BY INTERVENERS)
3 SAN DIEGO MUNICIPAL)
4 EMPLOYEES' ASSOCIATION; SAN DIEGO)
5 CITY FIREFIGHTERS LOCAL 145, IAAF,)
6 AFL-CIO; LOCAL 127,)
7 AMERICAN FEDERATION OF STATE,)
8 COUNTY AND MUNICIPAL EMPLOYEES,)
9 AFL-CIO; AND SAN DIEGO POLICE)
10 OFFICERS ASSOCIATION.)
11
12
13
14

15 This matter comes on for a hearing this 12th day of May, 2000, in Department 63 of the
16 Superior Court of the State of California, in and for the County of San Diego, the Honorable Robert
17 E. May, on a motion brought concurrently by each party and intervener to approve the terms of a
18 settlement. Appearing for the plaintiffs and plaintiffs in intervention were Michael A. Conger, Ann
19 M. Smith, Ann M. Smith specially appearing for Anthony R. Segall, Joel N. Klevens, and Richard
20 H. Castle. David B. Hopkins appeared for the defendant, the real party in interest and cross-
21 complainants.

22 Based on the arguments and evidence presented, and after due consideration of the factors
23 as set forth in *Dunk v. Ford Motor Company* (1996) 48 Cal.App.4th 1794, 1801, and of the four
24 objections the court has received to the proposed settlement,

25 IT IS ORDERED, ADJUDGED AND DECREED that the proposed settlement as set forth
26 in the "Notice of Proposed Settlement of Class Action," filed April 4, 2000 (and attached at Tab #1),
27 clarified by the terms set forth in the "Clarification of Settlement Terms" (attached at Tab #2) is
28 approved by the court.

29 Date: MAY 17 2000

ROBERT E. MAY

HON. ROBERT E. MAY
Superior Court of The State of California
County of San Diego

Int MSJ 000651



TAB #1

Int MSJ 000652

0930-0003



FILED
STEPHEN THUNBERG
Clerk of the Superior Court

APR 04 2000

By: BARBARA J. JONES, Deputy

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SAN DIEGO (CENTRAL DIVISION)

WILLIAM J. CORBETT; DONALD B. ALLEN;
LEONARD LEE MOORHEAD; AND GORDON L.
WILSON; individually and on behalf of those similarly
situated,

Plaintiffs,

vs.

CITY EMPLOYEES' RETIREMENT SYSTEM and
DOES 1 through 50, inclusive.,

Defendants.

CITY OF SAN DIEGO,

Real Party in Interest.

RELATED COMPLAINTS IN INTERVENTION BY
INTERVENERS SAN DIEGO MUNICIPAL
EMPLOYEES' ASSOCIATION; SAN DIEGO CITY
FIREFIGHTERS LOCAL 145, IAAF, AFL-CIO; LOCAL
127, AMERICAN FEDERATION OF STATE, COUNTY
AND MUNICIPAL EMPLOYEES, AFL-CIO; AND SAN
DIEGO POLICE OFFICERS ASSOCIATION

AND RELATED CROSS-ACTIONS.

CASE NO. 722449

NOTICE OF
PROPOSED SETTLEMENT
OF CLASS ACTION

I/C Judge Robert E. May
Dept. 63
Date May 12, 2000
Time: 11:30 a.m.
Complaint Filed: July 16, 1998

NOTICE TO CLASS MEMBERS OF PROPOSED SETTLEMENT
IMPORTANT NOTICE ABOUT YOUR RETIREMENT BENEFITS
FROM THE SUPERIOR COURT FOR THE STATE OF CALIFORNIA
COUNTY OF SAN DIEGO

Int MSJ 000653.

NOTICE OF PROPOSED
SETTLEMENT OF CLASS ACTION

5.17383736.9

0930-0004



I.

INTRODUCTION

Please read this Notice carefully if you either currently receive, or will be entitled to receive in the future, retirement benefits from the San Diego City Employees' Retirement System ("SDCERS") as a result of employment with the City of San Diego ("THE CITY"), or are otherwise a member of the "PLAINTIFF CLASS," as described below. A copy of this Notice will also be posted on THE CITY's web site: www.ci.san-diego.ca.us; go to City Hall and then to the City Attorney Section.

The named parties and their counsel of record have reached a proposed Settlement of this case. To become effective, the proposed Settlement must be approved by the Court. To determine whether the Court should approve the proposed Settlement, there will be a hearing on May 12, 2000, at 11:30 a.m. before the Honorable Robert E. May in Department 63 of the Superior Court for the State of California, County of San Diego, located at 330 West Broadway, San Diego, California 92101. The hearing will continue through the lunch hour, and thereafter until it is completed.

If you are a member of the "PLAINTIFF CLASS" and wish to object to the proposed Settlement, you have an opportunity to do so by following the procedures set out in this Notice. You may attend the May 12 hearing in any event, whether you object to the proposed Settlement or not. It is possible that there will also be a hearing on or before that date on the issue of attorneys' fees. If so, you will be advised by a separate Notice. Attorneys' fees are discussed more completely below, starting on page 9.

If the Settlement is approved by the Court, and if you are a member of the "PLAINTIFF CLASS," the Settlement will be binding on you whether or not you have objected to the Settlement. If the Settlement is approved, the "PLAINTIFF CLASS" will receive certain increased retirement benefits or disability retirement benefits, and each member is giving up his/her right to trial and giving up all claims which could have been brought or pursued in this lawsuit concerning the definition of Compensation, base compensation, Compensation Earnable or Final Compensation under the Municipal Code for purposes of calculating retirement benefits payable by SDCERS.

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Int MSJ 000654



1 THE PLAINTIFF CLASS CONSISTS OF ALL PERSONS WHO MAY CLAIM ANY
2 RIGHT, WHETHER OR NOT CURRENTLY VESTED, TO RECEIVE RETIREMENT BENEFITS
3 FROM THE SAN DIEGO CITY EMPLOYEES RETIREMENT SYSTEM ("SDCERS") AS A
4 RESULT OF EMPLOYMENT BY THE CITY OF SANDIEGO ("THE CITY"), INCLUDING BUT
5 NOT LIMITED TO ALL SUCH CURRENT EMPLOYEES OF THE CITY (INCLUDING THOSE
6 WHO HAVE ELECTED TO PARTICIPATE IN THE DEFERRED RETIREMENT OPTION PLAN
7 ("DROP")), FORMER EMPLOYEES OF THE CITY WHOSE RETIREMENT BENEFITS MAY
8 BE DEFERRED, RETIRED FORMER EMPLOYEES OF THE CITY CURRENTLY RECEIVING
9 RETIREMENT BENEFITS FROM SDCERS, ALL CURRENT MEMBERS OF SDCERS AS A
10 RESULT OF EMPLOYMENT BY THE CITY, AND PERSONS WHO MAY CLAIM
11 RETIREMENT BENEFITS FROM SDCERS AS A RESULT OF SOME OTHER PERSON'S
12 CURRENT OR PAST EMPLOYMENT BY THE CITY, SUCH AS AS A BENEFICIARY,
13 SURVIVOR, SUCCESSOR IN INTEREST, OR AS A PAYEE UNDER A DOMESTIC
14 RELATIONS ORDER ("DRO") RELATING TO THE RETIREMENT BENEFITS OF ANOTHER
15 PERSON WHO IS OR WAS A CURRENT OR FORMER EMPLOYEE OF THE CITY. THE
16 LAWSUIT CONCERNS THE CALCULATION OF RETIREMENT BENEFITS PAID BY
17 SDCERS TO ALL MEMBERS OF THE CLASS AS A RESULT OF ANY EMPLOYMENT WITH
18 THE CITY, AND THE CONTRIBUTIONS REQUIRED TO BE PAID TO RECEIVE THOSE
19 BENEFITS.

20 II.

21 PROCEDURAL HISTORY AND NATURE OF THE CLAIMS

22 Plaintiffs William J. Corbett, Donald B. Allen, Leonard Lee Moorhead and Gordon L. Wilson
23 filed this action on July 16, 1998 and filed a First Amended Complaint on October 28, 1998.
24 Generally, plaintiffs alleged that retirement benefits paid by SDCERS as a result of employment by
25 THE CITY had not been properly calculated in light of the California Supreme Court's August 1997
26 decision in Ventura County Deputy Sheriff's Association v. Board of Retirement of Ventura County
27 Employees' Retirement Association.

28 ///

Int MSJ 000655



1 In Ventura, the California Supreme Court ruled that the Retirement Board in that case was
2 required to classify certain payments made by the County of Ventura to its employees over and above
3 their basic salaries as "compensation earnable" and to include those payments in "final
4 compensation" used to calculate the amount of monthly pension benefits payable to the retired
5 employees under the County Employees' Retirement Law of 1937 ("CERL"), Government Code
6 Section 31450, *et seq.* Plaintiffs in this case allege that the same rationale should be applied to
7 certain payments made by THE CITY.

8 On February 3, 1999, Defendant SDCERS and Real Party in Interest THE CITY filed an
9 Answer and Cross-Complaint alleging, generally, that retirement benefits have been properly
10 calculated and paid under applicable law and according to agreements and long-standing practices
11 and, in the alternative, that, if retirement benefits must be increased to certain payees, the Court must
12 also determine the allocation among the parties of the costs of those increased benefits.

13 Thereafter, the following four unions intervened on behalf of their bargaining units. The
14 union plaintiffs in intervention are: the Municipal Employees Association (MEA); Firefighters
15 Local 145; AFSCME Local 127; and the San Diego Police Officer's Association (POA). Generally,
16 each of the four unions asserts that, as the exclusive bargaining agent for certain active employees,
17 it has an interest in the outcome of this litigation and the issues presented herein.

18 On November 19, 1999, the Court signed an order certifying this case as a class action,
19 because the outcome of the case was likely to impact all SDCERS members who claim any right to
20 receive retirement or disability retirement benefits from SDCERS as a result of employment by THE
21 CITY, whether they were actively involved in the case or not. The Court also ordered that all
22 members of the PLAINTIFF CLASS be notified that this case was pending and could affect the
23 rights of members of the PLAINTIFF CLASS. A Notice of Pendency of Class Action was approved
24 by the Court and delivered to members of the PLAINTIFF CLASS in February and March 2000.
25 On March 10, 2000, the Court scheduled a hearing on the plaintiffs' planned petition for a writ of
26 mandate for May 26, 2000.

Int MSJ 000656

27 On March 1 and March 13, 2000, all of the parties and counsel in this case participated in a
28 mediation with Howard B. Wiener, a retired Justice of the Court of Appeal of the State of California.



1 As a result of the mediation, the parties and counsel were able to reach an agreement to settle the
2 case. Each of the parties and counsel recognized that the litigation presented risks, and that the case
3 could result in an outcome more favorable or less favorable to any party.

4 III.

5 DESCRIPTION OF THE SETTLEMENT

6 A. Proposed Settlement for All Class Members (or Their Beneficiaries) who are
7 Vested Retired Members of SDCERS as a Result of Employment with the City
8 or Retired From Employment by the City of San Diego on or Before July 1, 2000.

9 If you are receiving retirement benefits, or disability retirement benefits, from SDCERS as
10 a result of active employment with THE CITY that terminated on or before July 1, 2000 (including
11 former DROP participants who have ceased active employment prior to July 1, 2000), or if you are
12 a vested deferred member of SDCERS as a result of employment with THE CITY, your retirement
13 benefit payment (with the exception of the Supplemental COLA adjustment and the Annual
14 Supplemental Benefit (the "13th check")) will increase by a simple seven per cent (7%), both
15 prospectively and retroactively. This seven per cent (7%) will apply to all such retirement benefit
16 payments you (or your DROP account) have received since July 1, 1995, and will receive in the
17 future. You will receive the retroactive payment in a single lump sum payment in approximately late
18 October, 2000 at the time the Annual Supplemental Benefit (the "13th check") is normally
19 distributed. If you have chosen to leave the balance of your DROP account retained by SDCERS,
20 you may elect to have your retroactive payment deposited in that account.

21 Each year, these payments are contingent on SDCERS having sufficient Surplus
22 Undistributed Earnings to pay them under the section of the Municipal Code concerning the use of
23 SDCERS Surplus Undistributed Earnings (SDMC § 24.1502) after the Annual Supplemental Benefit
24 (the "13th check"). To the extent these amounts are not paid in any year because there are insufficient
25 Surplus Undistributed Earnings, they will be carried forward as a contingent liability which will be
26 paid in future years in which there are sufficient Surplus Undistributed Earnings to pay them under
27 the statute. Liabilities carried forward will be paid in the order in which they accrued.

28 Each year, the right to receive these payments will be accrued monthly. However, they will
be paid annually, subject to the contingency, approximately five months after the close of SDCERS



1 fiscal year (at the time the Annual Supplemental Benefit (the "13th check") is normally distributed).
2 Thus, subject to the contingency, in approximately October 2000, the retroactive payment will be
3 distributed and in approximately October 2001, the seven percent (7%) increased benefit for the
4 fiscal year July 1, 2000 through June 30, 2001 will be distributed.

5 Payments pursuant to this proposed Settlement will be paid with respect to estates of retired
6 members only in the event there is a designated beneficiary eligible for a continuance (hereinafter,
7 "Beneficiary") to the retirement benefit and, in that event, will be paid only to the designated
8 Beneficiary at the time the payment is made. As a hypothetical example, if a member who was
9 retired prior to July 1, 1995 died on June 30, 1997 and designated a Beneficiary, the retroactive
10 payment paid to the Beneficiary will be seven percent (7%) of the full retirement benefit for the two-
11 year period from July 1, 1995 through June 30, 1997 and seven percent (7%) of the Beneficiary's
12 benefit for the remaining three years of the retroactive period. (In both instances, the retirement
13 benefit excludes any Supplemental COLA adjustment and the Annual Supplemental Benefit (the
14 "13th check")). Similarly, as another hypothetical example, if a retired member should die on
15 December 15, 2000 and designate a Beneficiary, and there are sufficient Surplus Undistributed
16 Earnings to pay the seven percent (7%) increase for the fiscal year starting July 1, 2000, the
17 Beneficiary will receive, in approximately October 2001, a sum equal to seven percent (7%) of the
18 full retirement benefit for the five-month period July through November 2000 and seven percent
19 (7%) of the Beneficiary benefit for the seven-month period December 2000 through June 2001.
20 (Again, in both instances, the retirement benefit is calculated with the exception of the Supplemental
21 COLA Adjustment and the Annual Supplemental Benefit (the "13th check")). If there is no
22 designated Beneficiary with respect to the account, there will be no payments under the proposed
23 Settlement with respect to any estate of a retired member who dies prior to a payment date.

24 The increased retirement benefit payment described in this section will not be paid to Special
25 Safety Class members (also known as "the fluctuators") or their beneficiaries because their
26 retirement benefits are not based on the Municipal Code provisions concerning the definition of
27 Compensation, base compensation, Compensation Earnable or Final Compensation.

28 ///

Int MSJ 000658



1 The seven percent (7%) increase in retirement benefits paid to retired members of the
2 PLAINTIFF CLASS is less than the ten percent (10%) increase that active employees may elect to
3 receive (as described below), because retired employees did not make contributions to SDCERS
4 during the period of their employment for these increased benefits, while active employees will make
5 contributions for their increased benefits in the future.

6 **B. Proposed Settlement for All Active Employee "Safety Members" as Defined by**
7 **the San Diego Municipal Code.**

8 If you are employed by THE CITY at any time on or after July 1, 2000, and are classified as
9 a Lifeguard or a Safety Member of SDCERS, you will be allowed, as a vested benefit, to make an
10 election at the time of your retirement between the following two choices for the calculation of your
11 retirement benefit (with the exception of the Supplemental COLA adjustment and the Annual
12 Supplemental Benefit (the "13th check")):

- 13 1. Your Retirement Calculation Factor will be increased from 2.5% (2.2% for
14 Lifeguards) at age 50 to 3.0% at age 50 and all subsequent years; or
- 15 2. Your retirement benefit will be calculated on the basis of the Retirement Calculation
16 Factors in effect on June 30, 2000, and your retirement benefit (with the exclusion of
17 the Supplemental COLA adjustment and the annual Supplemental Benefit (the "13th
18 check")) so computed will be increased by ten per cent (10%).

19 Starting on July 1, 2001, which is one year after the Effective Date of the Settlement (July 1,
20 2000), your employee contribution to SDCERS will increase by an amount to be determined by
21 SDCERS' actuary (currently estimated to be 1.23% for Lifeguards and .53% for other Safety
22 members) as the employee normal contribution to fund the payment of additional retirement benefits.
23 Your employee contribution will not increase to pay for the additional cost of the choice described
24 above (currently estimated to be .16%). That amount will be paid from an existing SDCERS reserve
25 for employee benefits until that reserve is exhausted (estimated to occur in approximately 20 years).

26
27
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Int MSJ 000659

NOTICE OF PROPOSED
SETTLEMENT OF CLASS ACTION

5.170383736.9



1 C. Proposed Settlement for All Active Employee "General Members" as Defined in
2 the San Diego Municipal Code.

3 If you are employed by THE CITY at any time on or after July 1, 2000, and are classified as
4 a General Member of SDCERS, you will be allowed, as a vested benefit, to make an election at the
5 time of your retirement between the following two choices for the calculation of your retirement
6 benefit (with the exception of the Supplemental COLA adjustment and the Annual Supplemental
7 Benefit (the "13th check")):

- 8 1. Your Retirement Calculation Factor will be increased from 2.0% at age 55 (stepping
9 up to 2.55% at age 65 and all subsequent years) to 2.25% at age 55 (stepping up to
10 2.55% at age 65 and all subsequent years); or
- 11 2. Your retirement benefit will be calculated on the basis of the Retirement Calculation
12 Factors in effect on June 30, 2000, and your retirement benefit (with the exclusion of
13 the Supplemental COLA adjustment and the Annual Supplemental Benefit (the "13th
14 check") so computed will be increased by ten per cent (10%).

15 Starting on July 1, 2001, which is one year after the Effective Date of the Settlement (July 1,
16 2000), your employee contribution to SDCERS will increase by an amount to be determined by
17 SDCERS' actuary (currently estimated to be .49%) as the employee normal contribution to fund the
18 payment of additional retirement benefits. Your employee contribution will not increase to pay for
19 the additional cost of the choice described above (currently estimated to be .16%). That amount will
20 be paid from an existing SDCERS reserve for employee benefits until that reserve is exhausted
21 (estimated to occur in approximately 20 years.)

22 D. Proposed Settlement for All Active Employee "Legislative Members" as Defined
23 in the San Diego Municipal Code.

24 If you are employed by THE CITY at any time on or after July 1, 2000, and are classified as
25 a Legislative Member of SDCERS, your retirement benefit will be calculated on the basis of the
26 Retirement Calculation Factors in effect as of June 30, 2000 and your retirement benefit (with the
27 exclusion of the Supplemental COLA adjustment and the Annual Supplemental Benefit (the "13th
28 check")) so computed will be increased by ten per cent (10%), as a vested benefit. Your employee



1 contribution will increase to pay for this increased benefit in the same amounts as are currently
2 estimated for General Members (.49%, plus .16%), which will be paid in the same manner and on
3 the same schedule as for General Members.

4 **E. Proposed Settlement for All Currently Employed DROP Participants.**

5 If you have elected, or elect prior to July 1, 2000, to participate in THE CITY's Deferred
6 Retirement Option Program ("DROP"), and are still actively employed by THE CITY as of July 1,
7 2000, any retirement benefit payments payable into your DROP account prior to July 1, 2000 (with
8 the exception of any Supplemental COLA adjustment and the Annual Supplemental Benefit (the
9 "13th check")) will be increased by seven per cent (7%) (the "Retroactive Payment"), and all such
10 retirement benefit payments to be made on or after July 1, 2000, into your DROP account or
11 otherwise, will be increased by ten per cent (10%) (the "Prospective Payment"). Your Retroactive
12 Payment will be paid in approximately October 2000 at the time the Annual Supplement Benefit (the
13 "13th check") is normally distributed. Your Retroactive Payment is contingent on SDCERS having
14 sufficient Surplus Undistributed Earnings to pay it under the section of the Municipal Code
15 concerning the use of SDCERS Surplus Undistributed Earnings (SDMC § 24.1502) after the Annual
16 Supplemental Benefit (the "13th check"). To the extent the Retroactive Payment is not paid in any
17 year because there are insufficient Surplus Undistributed Earnings, it will be carried forward as a
18 contingent liability which will be paid in future years in which there are sufficient Surplus
19 Undistributed Earnings to pay it under the statute. Liabilities carried forward will be paid in the
20 order in which they accrued. Your ten percent (10%) Prospective Payment described above is not
21 contingent and is a vested benefit.

22 **F. Payment of Attorneys' Fees.** SDCERS and THE CITY have tentatively agreed with counsel
23 for Plaintiffs and the Intervenor to pay them a specific total amount in satisfaction of all their claims
24 for attorneys' fees and costs incurred and to be incurred with respect to this case. The tentative
25 agreement is subject only to the approval of the governing bodies of SDCERS and THE CITY,
26 respectively, at meetings scheduled to take place during the week of April 10, 2000. If the tentative
27 agreement regarding attorneys' fees and costs is approved, you will not have to pay any attorneys'

28 ///

Int MSJ 000661

NOTICE OF PROPOSED
SETTLEMENT OF CLASS ACTION



1 fees or costs with respect to this case, nor will there be any deductions from payments you receive
2 pursuant to the proposed settlement.

3 Starting the afternoon of April 14, 2000, you may learn whether the tentative agreement
4 regarding reasonable attorneys' fees has been approved and, if so, the amount of the reasonable
5 attorneys' fees and costs to be paid collectively by SDCERS and THE CITY, by accessing THE
6 CITY'S web site at www.ci.san-diego.ca.us and going first to City Hall and then to the City Attorney
7 Sections. In the alternative, you can receive that information starting the afternoon of April 14, 2000
8 by calling 619-236-7373 to receive a recorded message.

9 If the tentative agreement regarding attorneys' fees and costs is NOT approved, in addition
10 to being so advised on the web site, you will also be advised of the schedule on which the Court will
11 hear motion(s) to be filed by Counsel for the PLAINTIFF CLASS and SUB-CLASSES to recover
12 reasonable attorneys' fees and costs, and how this issue might affect the proposed Settlement.

13 IV.

14 TIMING, PROCEDURES, CONDITIONS AND EFFECTIVE DATE

15 A condition precedent to the Settlement is confirmation from the SDCERS actuary that the
16 terms of the proposed Settlement will not cause the SDCERS funded ratio to fall below 90% as of
17 July 1, 2000. This condition has been satisfied with respect to the payments to be made to the
18 PLAINTIFF CLASS.

19 This Notice contains the terms of the proposed Settlement. Once approved by the Court, this
20 Notice becomes the Settlement and this Notice becomes the formal and complete Settlement
21 Agreement.

22 If the proposed Settlement is approved by the Court, THE CITY must pass necessary
23 ordinances to implement it. Conditions subsequent to the Settlement will be the approval of those
24 ordinances by the SDCERS membership as required by the San Diego Municipal Code, and a
25 determination by counsel for the PLAINTIFF CLASS and SUB-CLASSES that the ordinances
26 effectively implement the Settlement.

Int MSJ 000662

27 Nothing in this Settlement shall be deemed to grant to any party any approval rights over any
28 other actions of THE CITY. All parties acknowledge that THE CITY is considering changing



1 portions of the Municipal Code affecting the SDCERS Retirement Plan, including changing or
2 eliminating the provisions concerning Compensation, base compensation, Compensation Earnable,
3 and/or Final Compensation, and that nothing in this Settlement shall affect in any way the power of
4 THE CITY to do so or the negotiating right of THE CITY's labor organizations.

5 If the conditions subsequent are not satisfied, the Settlement is void and the litigation will
6 resume.

7 If the Court approves the Settlement, the effective date will be July 1, 2000, and all
8 entitlements to payments under the Settlement will accrue as of that date. Nevertheless, SDCERS
9 may not make payments as required under the Settlement until after the conditions subsequent have
10 been satisfied.

11 V.

12 THE SETTLEMENT HEARING AND OPTIONS OF CLASS MEMBERS

13 Because of the nature of this lawsuit, you will not have an opportunity to be excluded from
14 the Settlement of this case if it is approved by the Court. That means that, if and when the
15 Settlement is approved by the Court, you will be bound by it. If you wish you may, however, object
16 to the terms of the Settlement.

17 If you object to the terms of the Settlement, you may appear in person or through your
18 attorney and be heard in opposition. You may object on the grounds of the fairness, reasonableness,
19 and adequacy of the Settlement by delivering no later than May 4, 2000 to counsel for your SUB-
20 CLASS at the address set out below documentary proof that you are a member of the Settlement
21 class and a written statement of the basis of your objection. Mr. Conger will provide to the Court
22 and all other counsel copies of any objections, together with an index, by May 8, 2000.

23 VI.

24 NOTICE OF ATTORNEYS OF RECORD

25 If you submit any objections or other papers regarding the proposed Settlement, a copy should
26 be sent to the attorney for your Sub-Class at the address listed below:

27

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Int MSJ 000663



1. Michael A. Conger, Esq., Law Offices of Michael Conger, 2169 First Avenue, San Diego, CA 92101, phone (619) 234-1511, fax (619) 230-1074; e-mail: congermike@aol.com, attorney for both "Sub-classes A and F," which consist of:

Sub-class A: All former employees of the CITY who are classified as retired by SDCERS (including those who have elected to participate in the Deferred Retirement Option Plan ("DROP")); and

Sub-class F: All other persons not included in Sub-classes A, B, C, D, or E, as described here, who are in the class (that is, all persons who may claim any right, whether or not currently vested, to receive retirement benefits from SDCERS as a result of employment by the CITY), but who are not members of any of Sub-classes A through E. This sub-class includes current employees who are legislative officers, unclassified employees and unrepresented employees (including those who have elected to participate in the Deferred Retirement Option Plan ("DROP")). This sub-class also includes all persons who may claim any right, whether or not currently vested, to receive retirement benefits from SDCERS as a result of any other person's current or past employment by the CITY (including those who have elected to participate in the Deferred Retirement Option Plan ("DROP")), including as a current or former employee's beneficiary, survivor, or successor in interest, or as a payee under a Domestic Relations Order relating to the retirement benefits of some other person currently or formerly employed by the CITY.

2. Ann M. Smith, Esq. of Tosdal Levine Smith & Steiner, 600 B Street, Suite 2100, San Diego, CA 92101, phone (619) 239-7200, fax (619) 239-6048; e-mail: ASMITH@tlsslaw.com, attorney for "Sub-class B," which consists of:

All current employees of the CITY (including those who have elected to participate in the Deferred Retirement Option Plan ("DROP")) employed in positions within any of the following bargaining units represented by San Diego Municipal Employees' Association ("MEA") as exclusive bargaining agent: (1) Administrative and Field Support, or (2) Technical, or (3) Professional, or (4) Supervisory. Plaintiff in Intervention MEA shall be the representative of all members of Sub-Class B.

3. Joel N. Klevens, Esq. of Fogel, Feldman, Ostrov, Ringler & Klevens, 1620 26th St., Ste. 100 South Tower, Santa Monica, CA 90404-6711, phone (310) 453-6711, fax (310) 828-2191; e-mail: JoelK@FFORK.com, attorney for "Sub-class C," which consists of:

All current employees of the CITY (including those who have elected to participate in the Deferred Retirement Option Plan ("DROP")) who are represented by San Diego City Firefighters Local 145, IAAF, AFL-CIO ("Firefighters Local 145") as exclusive bargaining agent and are employed as either a: (1) Fire Recruit; (2) Fire Fighter I; (3) Fire Fighter II; (4) Fire Engineer; (5) Fire Captain; (6) Fire Battalion Chief;

Int MSJ 000664



(7) Fire Prevention Inspector I; (8) Fire Prevention Inspector II; (9) Fire Prevention Supervisor; (10) Assistant Fire Marshall; (11) Emergency Medical Technician; (12) Paramedic I; (13) Paramedic II; or (14) Medical Operations Coordinator. Plaintiff in Intervention Firefighters Local 145 shall be the representatives of all members of Sub-Class C.

4. Anthony R. Segall, Esq. of Rothner, Segall & Greenstone 200 East Del Mar Boulevard, Suite 200, Pasadena, CA 91105-2544, phone (626) 796-7555, fax (626) 577-0124, attorney for Sub-Class D, which consists of:

All current employees of the CITY (including those who have elected to participate in the Deferred Retirement Option Plan ("DROP")) employed in positions within the Maintenance, Labor, Skilled Trades and Equipment Operator Unit represented by Local 127, American Federation of State, County and Municipal Employees, AFL-CIO, ("AFSCME Local 127") as exclusive bargaining agent.

5. Richard H. Castle, Jr., Esq., of Castle & Krause, 41877 Enterprise Circle North, Suite 140, Temecula, CA 92590, phone (909) 694-8884, fax (909) 699-8634, attorney for Sub-Class E, which consists of:

All current employees of the CITY of San Diego (including those who have elected to participate in the Deferred Retirement Option Plan ("DROP")) who are represented by the San Diego Police Officers Association ("POA") as exclusive bargaining agent.

6. David B. Hopkins, Esq., Hillyer & Irwin, 500 West C Street, Suite 1600, San Diego, CA 92101, phone (619) 234-6121, fax (619) 595-1313, attorney for SDCERS and THE CITY.

VII.

CHANGE OF ADDRESS

If you move after receiving this notice or if it was misaddressed, and if you are a deferred or retired member, beneficiary, survivor or successor in interest of any member of SDCERS who claims benefits as a result of employment with THE CITY, you should supply your name and correct address to the San Diego City Employees' Retirement System. If you are an active employee of THE CITY, you should supply that information to the payroll department of the City of San Diego. **THIS IS IMPORTANT SO THAT FUTURE NOTICES REACH YOU.**

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Int MSJ 000665



VIII

EXAMINATION OF PAPERS AND INQUIRIES

The pleadings and all of the records of this litigation may be examined and copied at any time during regular office hours of the Clerk of the Superior Court at the Hall of Justice, Second Floor, Room 225 (Civil Records and Filings), 330 West Broadway, San Diego, California 92101.

IF YOU HAVE QUESTIONS OR COMMENTS, DO NOT CALL OR WRITE TO THE COURT OR THE CLERK OF THE COURT. PLEASE ADDRESS ALL INQUIRIES IN WRITING TO THE COUNSEL FOR YOUR SUB-CLASS, STATED ABOVE.

ROBERT E. MAY


Date: APR 04 2000

HON. ROBERT E. MAY
Superior Court of The State of California
County of San Diego

SO APPROVED AS THE SETTLEMENT AGREEMENT, SUBJECT TO COURT
APPROVAL:

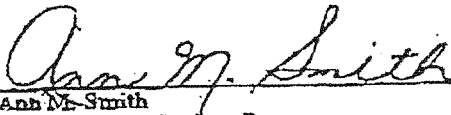
Date: 3/31/00

LAW OFFICES OF MICHAEL CONGER


Michael A. Conger
Attorney for Sub-classes A and F

Date: April 3, 2000

TOSDAL LEVINE SMITH & STEINER


Ann M. Smith
Attorney for Sub-class B

Date: 4/3/2000

FOGEL, FELDMAN, OSTROV, RINGLER &
KLEVENS, a Law Corporation


Joel N. Klevens
Attorney for Sub-class C



HILLYER IRWIN

0017

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ROTHNER, SEGALL & GREENSTONE

Anthony R. Segall
Anthony R. Segall
Attorney for Sub-Class D

CASTLE & KRAUSE

Richard H. Castle, Jr.
Richard H. Castle, Jr.
Attorney for Sub-Class E

HILLYER & IRWIN

David B. Hopkins
David B. Hopkins
Attorney for SDCERS and THE CITY

SDCERS RETIREMENT BOARD OF
ADMINISTRATION

Lawrence B. Grissom
Lawrence B. Grissom
Its Administrator

CITY OF SAN DIEGO

Michael T. Ubernaga
Michael T. Ubernaga
Its City Manager



TAB #2

Int MSJ 000668

0930-0019



CLARIFICATION OF SETTLEMENT TERMS

Corbett, et al v. City Employees' Retirement System, et al, Case # 722449

The terms of the settlement agreement as set forth in the "Notice of Proposed Settlement of Class Action," filed April 4, 2000, are clarified as follows:

1. **Supplemental COLA.** Payments made under the *Corbett* settlement will not reduce the supplemental cost of living increase given to eligible SDCERS retirees.
2. **Reciprocity Agreements.** The settlement affects only the retirement benefits to be paid by SDCERS to a class member. If a class member receives (either now or in the future) retirement benefits from both SDCERS and from some other reciprocating body, the increased retirement benefits resulting from the *Corbett* settlement apply to the benefits to be paid by SDCERS, but not to the benefits to be paid by any other reciprocating entity which is not a party to the settlement. Similarly, the settlement affects only the contribution rates of class members related to their employment with the City, and not with any other reciprocating entity.
3. **General Member Retirement Calculation Factors Starting at Age 55.** The exact steps for increasing the Retirement Calculation Factor from 2.25% at age 55 up to 2.55% at age 65 and all subsequent years which general members may elect at the time of retirement are as follows:

Age	Retirement Calculation Factor
55-59	2.25%
60	2.3%
61	2.35%
62	2.4%
63	2.45%
64	2.5%
≥65	2.55%

4. **Estimated Dates for Contingent Payments.** The contingent payments to class members who are retired as of June 30, 2000, and the contingent payments to DROP participants for the period prior to July 1, 2000 will be made "in approximately November" of the applicable year, as opposed to "in approximately October."

Clarification of Settlement Terms

Corbett, et al v. City Employees' retirement System, et al, Case # 722449

Page 1

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0930-0020



5. Costs and Attorneys' Fees. Costs and attorneys' fees in the total amount of \$1.2 million are to be paid by the City and SDCERS to counsel for the plaintiff sub-classes.

Clarification of Settlement Terms

Corbett, et al v. City Employees' Retirement System, et al, Case # 722449

Page 2

Int MSJ 000670

0930-0021



Exhibit 17

CONSENT MOTION BY MADAFFER TO ADOPT. Second by Maienschein. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

- * ITEM-133: Two actions related to Approval of Agreements on SDCERS Board Indemnification & City SDCERS Employer Contributions.

CITY MANAGER'S RECOMMENDATION:

Adopt the following resolutions:

Subitem-A: (R-2003-390) ADOPTED AS RESOLUTION R-297335

Declaring that the City of San Diego agrees to defend, indemnify and hold harmless the members of the Board of Administration for the San Diego City Employees' Retirement System in the performance of their duties.

Subitem-B: (R-2003-661) ADOPTED AS RESOLUTION R-297336

Authorizing the City to enter into an agreement with the San Diego City Employees' Retirement System regarding employer contributions.

CITY MANAGER SUPPORTING INFORMATION:

Board Indemnification: Section 141 of the San Diego City Charter created the San Diego City Employees' Retirement System (SDCERS). Section 144 provides that SDCERS be administered by a thirteen (13) member governing board known as the Board of Administration (Board), which includes three members elected by the General Members of SDCERS, one member elected by the retirees of SDCERS, two members elected by the Safety Members of SDCERS, one Police, one Fire, respectively, three ex-officio members: City Manager, City Auditor, and City Treasurer, and four citizen members, one of which must be an officer of a local bank, are appointed by the Council and serve without compensation. Charter Section 144 grants the Board the sole authority to determine the rights and benefits eligibility from SDCERS, administer SDCERS, and invest the SDCERS trust fund; SDCERS Board Members may, from time to time, be subjected to claims and suits for actions taken in their capacity as such.

Due to the need to protect and encourage individuals who volunteer their time and their talent to serve in the public interest, approval of the resolution provides that the City shall defend,

indemnify and hold harmless all past, present and future members of the Retirement Board against all expenses, judgments, settlements, liability and other amounts actually and reasonably incurred by them in connection with any claim or lawsuit arising from any act or omission in the scope of the performance of their duties as Board Members under the Charter.

Employer Contributions: On June 7, 1996, the City proposed and the SDCERS Board of Administration ("Board") agreed to the City Manager's Retirement Proposal, as modified, ("Manager's Proposal") dated July 21, 1996. The Manager's Proposal sets out agreements between the City and SDCERS with respect to contributions to be made by the City to SDCERS starting in Fiscal Year 1996. As a result of the recently concluded meet and confer process, the City and the Board recognize that under the current method of determining City contributions to SDCERS, the annual level of contributions has the potential to become volatile and SDCERS' funding ratio has decreased in recent years. The City and the Board also recognize that, under current fiscal circumstances, undue hardship would be imposed on the City if the Board were to require that the City immediately increase its contributions to the full projected unit credit rate calculated by SDCERS' actuary. In response to those concerns, on June 18, 2002, the City requested the Board agree to an amended Manager's Proposal. On July 11, 2002, the Board approved modifications to the Manager's Proposal. This Agreement is entered into in order to provide a transition period for City contributions to be brought, by Fiscal Year 2009, to the full contribution rates that would be applied if the projected unit credit funding method were used, to provide accelerated contributions by the City if SDCERS' funding ratio goes below 82.3% before the end of the term of this Agreement, and to terminate all transition arrangements regarding contributions with the City at the end of Fiscal Year 2009. The attached agreement describes the current and proposed contribution arrangements.

Herring/Kelley

FILE LOCATION: SUBITEMS A & B: MEET

COUNCIL ACTION: (Time duration: 2:19 p.m. - 2:25 p.m.)

CONSENT MOTION BY MADAFFER TO ADOPT. Second by Maienschein. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

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DUPL

(R-2003-661)

RESOLUTION NUMBER R- 297336

ADOPTED ON NOV 18 2002

RESOLUTION OF THE CITY OF SAN DIEGO AUTHORIZING
THE CITY TO ENTER INTO AN AGREEMENT WITH THE
SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
REGARDING EMPLOYER CONTRIBUTIONS

WHEREAS, on June 7, 1996, the City of San Diego ("City") proposed and the Board of Administration ("Board") of the San Diego City Employees' Retirement System ("SDCERS") agreed to the City Manager's Retirement Proposal, as modified ("Manager's Proposal") dated July 21, 1996; and

WHEREAS, the section of the Manager's Proposal labeled "Issue No. 3 - EMPLOYER CONTRIBUTION RATES" ("Section 3 of the Manager's Proposal") sets out agreements between the City and SDCERS with respect to contributions to be made by the City to SDCERS starting in Fiscal Year 1996; and

WHEREAS, these agreements were made after due consideration of the then current financial situation of the City and of SDCERS and reasonable projections of these financial situations; and

WHEREAS, the City and the Board recognize that under the current method of determining City contributions to SDCERS, the annual level of contributions has the potential to become volatile and SDCERS' funding ratio has decreased in recent years; and

WHEREAS, the City and the Board also recognize that under current fiscal circumstances, undue hardship would be imposed on the City if the Board were to require that the City immediately increase its contributions to the full projected unit credit rate calculated by SDCERS' actuary; and

WHEREAS, on June 18, 2002, the City requested that modifications be made to Section 3 of the Manager's Proposal; and

WHEREAS, on July 11, 2002, after due consideration, the Board approved modifications to Section 3 of the Manager's Proposal, contingent on an appropriate written agreement between the City and the Board; and

WHEREAS, this new agreement ("Agreement") will provide a transition period for City contributions to be brought, by fiscal year 2009, to the full contribution rates that would be applied if the projected unit credit funding method were used; and

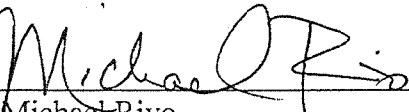
WHEREAS, this Agreement will provide accelerated contributions by the City if SDCERS' funding ratio goes below 82.3% before the end of the term of this Agreement; and

WHEREAS, this Agreement will terminate all transition arrangements with the City regarding contributions at the end of fiscal year 2009; NOW, THEREFORE,

BE IT RESOLVED, by the Council of the City of San Diego, that the City of San Diego is authorized to enter into an agreement with the San Diego City Employees' Retirement System

regarding employer contributions under the terms and conditions set forth in the Agreement on
file in the office of the City Clerk as Document No. RR- 297336.

APPROVED: CASEY GWINN, City Attorney

By 
Michael Rivo
Deputy City Attorney

MR:ms

11/6/02

Or.Dept: Manager's Office

R-2003-661

Passed and adopted by the Council of The City of San Diego on NOV 18 2002
by the following vote:

Council Members	Yeas	Nays	Not Present	Ineligible
Scott Peters	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Byron Wear	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Toni Atkins	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
George Stevens	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Brian Maienschein	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Donna Frye	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Jim Madaffer	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ralph Inzunza	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Mayor Dick Murphy	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

AUTHENTICATED BY:

(Seal)

DICK MURPHY

Mayor of The City of San Diego, California.

CHARLES G. ABDELNOUR

City Clerk of The City of San Diego, California.

By Manuel E. Kettner, Deputy.

Office of the City Clerk, San Diego, California

This information is available in alternative
formats upon request.

CC-1278 (Rev. 11-95)

Resolution R-297336 Adopted NOV 18 2002
Number

ORIGINAL

AGREEMENT REGARDING EMPLOYER CONTRIBUTIONS
BETWEEN THE CITY OF SAN DIEGO
AND THE SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

This Agreement Regarding Employer Contributions ("Agreement") is dated
NOV 18 2002, 2002, and is entered into by and between the City of San Diego
("City") and the San Diego City Employees' Retirement System ("SDCERS")

Background Facts

1. On June 7, 1996, the City proposed and the SDCERS Board of Administration ("Board") agreed to the City Manager's Retirement Proposal, as modified, ("Manager's Proposal") dated July 23, 1996.
2. The section of the Manager's Proposal labeled "Issue No. 3 – EMPLOYER CONTRIBUTION RATES" ("Section 3 of the Manager's Proposal") sets out agreements between the City and SDCERS with respect to contributions to be made by the City to SDCERS starting in Fiscal Year 1996. These agreements were made after due consideration of the then current financial situation of the City and of SDCERS and reasonable projections of these financial situations.
3. The City and the Board recognize that under the current method of determining City contributions to SDCERS, the annual level of contributions has the potential to become volatile and SDCERS' funding ratio has decreased in recent years.
4. The City and the Board also recognize that, under current fiscal circumstances, undue hardship would be imposed on the City if the Board were to require that the City immediately increase its contributions to the full projected unit credit rate calculated by SDCERS' actuary.
5. On June 18, 2002, the City requested that modifications be made to Section 3 of the Manager's Proposal.
6. On July 11, 2002, after due consideration, the Board approved modifications to Section 3 of the Manager's Proposal, contingent on an appropriate written agreement being entered into between the City and the Board.
7. This Agreement is entered into in order to provide a transition period for City contributions to be brought, by fiscal year 2009, to the full contribution rates that would be applied if the projected unit credit funding method were used, to provide accelerated contributions by the City if SDCERS' funding ratio goes below 82.3% before the end of the term of this Agreement, and to terminate all transition arrangements regarding contributions with the City at the end of fiscal year 2009.

DOCUMENT NO. R2-297336
FILED NOV 18 2002
OFFICE OF THE CITY CLERK
SAN DIEGO, CALIFORNIA

Agreement

For good and valuable consideration as set out herein, the City and SDCERS hereby agree as follows:

1. Effect on Manager's Proposal

Section 3 of the Manager's Proposal is entirely superceded and replaced by this Agreement.

2. City Contributions – Base Rates

- a. Based on the current benefits provided under SDCERS, and except as otherwise provided in this Agreement, the City's contribution rates, as a percentage of total City payroll, will be no less than the following (these are called the "Table Rates"):

FISCAL YEAR STARTING JULY 1 OF:	CONTRIBUTION RATE
2002	10.33%
2003	11.89%
2004	12.89%
2005	13.89%
2006	14.89%
2007	15.89%
2008	Full PUC contribution rates, subject to section 2(c) below

- b. If the City increases benefits payable under SDCERS in any manner and at any time, the Table Rates will increase, on July 1 of the fiscal year immediately following such increase in benefits, by the full contribution rate for the benefit increase as determined by SDCERS's actuary based on SDCERS' then applicable funding method and actuarial assumptions.
- c. The Table Rates will not be changed if the Board changes the actuarial assumptions that were used for determining contributions to SDCERS as of June 30, 2001
- d. Notwithstanding the Table Rates, the Board will instruct its actuary to determine what the City contribution rates to SDCERS would be for each fiscal year using

the projected unit credit ("PUC") method through the fiscal year beginning on July 1, 2008 and ending on June 30, 2009 and using the then appropriate actuarial assumptions. The Board also may instruct the actuary to determine what the contributions to SDCERS would be for such years using the entry age normal funding method or any other funding method desired by the Board.

- e. At any time, with the agreement of the Board, the City may contribute a larger amount to SDCERS than is provided by the Table Rates.

3. City Contributions – Effect of Reduced Funded Ratio

- a. If the Funded Ratio (which is defined below) of SDCERS is less than eighty two and three-tenths percent (82.3 percent) as of June 30 of any fiscal year ending within calendar years 2002 through 2009, then the City's rates of contributions to SDCERS shall be increased starting on July 1 of the fiscal year beginning one year after the fiscal year in which the Funded Ratio is less than 82.3 percent. The year beginning on such July 1 is called the "First Increase Year". For example, if the Funded Ratio is less than 82.3 percent on June 30, 2003, the First Increase Year is the fiscal year beginning on July 1, 2004 and ending on June 30, 2005.
- b. The increase in the City's rates shall be calculated as follows:
 - i. SDCERS' actuary will calculate the City's contribution rates to SDCERS for the First Increase Year and for every fiscal year thereafter through 2009 without regard to this Agreement, using the PUC funding method and SDCERS' actuarial assumptions that are in effect as of the date of this Agreement. (These rates are called the "Trigger PUC Rates".)
 - ii. SDCERS will determine the number of fiscal years between the First Increase Year and fiscal year beginning on July 1, 2008 and ending on June 30, 2009.
 - iii. In the First Increase Year, the City's contribution rates will increase by multiplying the difference between the Table Rates and the Trigger PUC Rates by a fraction which is (one) divided by (the number of fiscal years between the First Increase Year and the year ending on June 30, 2009) and adding the result of that multiplication to the Table Rate for the applicable fiscal year.
 - iv. In each fiscal year after the First Increase Year and through the fiscal year ending on June 30, 2009, the City's contribution rates will increase by multiplying the difference (which shall not be less than zero) between the contribution rate determined under this section 3(b) for the immediately preceding fiscal year and the Trigger PUC Rates by a fraction which is the same as the fraction in the above paragraph except that the denominator of the fraction is reduced by the numeral one for each year after the First

Increase Year, and adding the result of that multiplication to the Table Rate for the applicable fiscal year.

v. Examples

Assumptions – Example 1

- SDCERS Funded Ratio is less than 82.3% on 6/30/03
- The First Increase Year begins 7/1/04
- The Table Rate for the year beginning 7/1/04 is 12.89%
- The Trigger PUC Rate for the year beginning 7/1/04 is 22.29%
- The Trigger PUC Rate for the years beginning 7/1/06 is 24.29%
- The number of years between the First Increase Year and the fiscal year ending 6/30/09 is 5.

First date of contributions	Rate per Agreement	PUC Rate	Difference	Added %	Total
7/1/04	12.89	22.29	9.4	1.88	14.77
7/1/05	14.77	22.29	7.52	1.88	16.65
7/1/06	16.65	24.29	7.64	2.55	19.20
7/1/07	19.20	24.29	5.09	2.55	21.75
7/1/08	21.75	24.29	2.54	2.54	24.29

Assumptions – example 2

Same assumptions as example 1, except that for the years beginning 7/1/06 the Trigger PUC Rate is 16.00

First date of contributions	Rate per Agreement	PUC Rate	Difference	Added %	Total
7/1/04	12.89	22.29	9.4	1.88	14.77
7/1/05	14.77	22.29	7.52	1.88	16.65
7/1/06	16.65	16.00	0	0	16.65
7/1/07	16.65	16.00	0	0	16.65

7/1/08	16.65	16.00	0	0	16.65

- c. The "Funded Ratio" of SDCERS will be calculated as of the end of each fiscal year and will be determined by SDCERS' actuary in accordance with the following fraction:

- The numerator is the actuarial value of all SDCERS assets used in the actuary's annual valuation of SDCERS to determine the City's contribution rates for the relevant fiscal year
- The denominator is the actuarial accrued liability for the relevant fiscal year of SDCERS, determined by using the PUC funding method and the then current actuarial assumptions approved by the Board.

SDCERS' contingent liabilities to retirees under the "Corbett Settlement" will not be taken into account in determining the Funded Ratio.

- d. If the Funded Ratio becomes greater than 82.3 percent at any time after it is below 82.3 percent, this change will not affect the City contributions required under this section 3.

4. Sunset Provisions for Contribution Rates

- a. As of June 30, 2009, the provisions of sections 2 and 3 of this Agreement shall terminate in full. The Board shall determine the City's contribution rates, with the advice of the SDCERS actuary, for the fiscal year beginning on July 1, 2009 and for each succeeding year without regard to sections 2 and 3 hereof and without regard to the Manager's Proposal. Such determination shall include, but not be limited to, taking into account any changes in actuarial assumptions that are recommended by SDCERS's actuary and approved by the Board.
- b. The City and the Board agree that the Board will take all necessary and appropriate actions, starting with determining the City's contributions rates beginning on July 1, 2009, to rapidly bring the City's contributions to SDCERS to the contribution rates determined under the entry age normal funding method. The City will exercise its best efforts to contribute beginning on July 1, 2011, to SDCERS under the entry age normal funding method. Nothing in this Agreement shall limit the ability of the Board to establish contribution rates under any funding method for contributions beginning on and after June 30, 2009.

5. Miscellaneous Provisions

- a. This Agreement is conditioned on approval by the City Council of the City of San Diego and by the Board of Administration for the San Diego City Employees' Retirement System, and is conditioned on the direction and authorization by the Council and the Board of the execution of this Agreement by the signatories hereunder. The resolutions of the Council and of the Board establishing such authorization and direction are Attachments 1 and 2 to this Agreement.
- b. The Board may nullify this Agreement to the extent required by its duties established under the California Constitution and no one shall have any liability for losses or costs on account of such action.
- c. If the City fails to meet any of its obligations under this Agreement, then the City shall immediately contribute to SDCERS the projected unit credit rate determined under section 2, d above for the current fiscal year and all fiscal years remaining under this agreement, or the entry age normal rate if higher. The City shall have 30 days after receiving notice from SDCERS of any such failure to correct the failure(s).
- d. The City will pay to SDCERS any and all necessary or appropriate, direct and indirect, costs that SDCERS incurs in order to enforce this Agreement.
- e. This Agreement may be amended only by written modification after approval by both the City Council of the City of San Diego and the Board of Administration of the San Diego City Employees' Retirement System.

IN WITNESS WHEREOF, THE PARTIES HERETO HAVE EXECUTED THIS AGREEMENT ON THE DATES SET FORTH BELOW.

CITY OF SAN DIEGO

SAN DIEGO CITY EMPLOYEES'
RETIREMENT SYSTEM

By Michael T. Oberlander

By [Signature]

Title City Manager

Title PRESIDENT

Dated 12/11/02

Dated 12/3/02

R-297336

Approved as to form and legality this 26th
day of November, 2003

CASEY GWINN, City Attorney

By Michael Rivo

Michael Rivo

Deputy City Attorney

P-297336